

立法會
Legislative Council

LC Paper No. CB(1)2046/02-03
(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

**Minutes of meeting held on
Monday, 7 April 2003 at 10:00 am
in the Chamber of Legislative Council Building**

- Members present** : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)
Hon Henry WU King-cheong, BBS, JP (Deputy Chairman)
Hon Kenneth TING Woo-shou, JP
Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Hon Eric LI Ka-cheung, JP
Hon NG Leung-sing, JP
Hon James TO Kun-sun
Hon Bernard CHAN, JP
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP
Hon MA Fung-kwok, JP
- Non-Panel Members attending** : Hon Cyd HO Sau-lan
Hon Margaret NG
- Member absent** : Dr Hon David LI Kwok-po, GBS, JP

**Public officers
attending**

: Agenda Item IV

Miss Susie HO
Deputy Secretary for Financial Services and the
Treasury (Financial Services)

Mr Esmond LEE
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)

Ms Kinnie WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)

Mr Gordon JONES
Registrar of Companies

Ms Dorothy SILKSTONE
Registry Solicitor

Mr Edward LAU
Secretary, Standing Committee on Company Law
Reform

Agenda Item V

Mr Frederick MA
Secretary for Financial Services and the Treasury

Mr Tony MILLER
Permanent Secretary for Financial Services and the
Treasury (Financial Services)

Mr Gordon JONES
Registrar of Companies

Agenda Item VI

Mr Martin GLASS
Deputy Secretary for Financial Services and the
Treasury (Treasury) 2

Mr Allen LEUNG
Principal Assistant Secretary for Financial Services
and the Treasury (Treasury) (MA)

Miss Shandy LIU
Senior Government Counsel

**Attendance by
invitation**

: Agenda Item IV

Mr Roger BEST
Chairman, Financial Accounting Standards Committee

Ms Winnie CHEUNG
Senior Director, Hong Kong Society of Accountants

Mr William PEARSON
Director, Corporate Finance, Securities and Futures
Commission

Ms Sonia LEUNG
Senior Manager, Corporate Finance, Securities and
Futures Commission

Agenda Item V

Professor Stephen Y L CHEUNG
Department of Economic and Finance, City University
of Hong Kong

The Hong Kong Society of Financial Analysts

Mr Richard MAK
President

Mr James SOUTAR
Secretary

WEBB-SITE.COM

Mr David WEBB
Editor

Hong Kong Society of Accountants

Mr David SUN Tak-kei
President

Mr LEE Kai-fat
Registrar and Secretary-General

The Law Society of Hong Kong

Mr Simon LAI Sau-cheong
Member of Company & Financial Law Committee

Securities and Futures Commission

Mr Andrew SHENG
Chairman, Securities and Futures Commission

Mr Charles GRIEVE
Director of Accounting Policy, Securities and Futures
Commission (Corporate Finance Division)

Hong Kong Exchanges and Clearing Limited

Ms Karen LEE
Head, Listing, Regulation and Risk Management,
Hong Kong Exchanges and Clearing Limited

Mr Richard WILLIAMS
Senior Vice President, Hong Kong Exchanges and
Clearing Limited (Listing)

Clerk in attendance : Ms Connie SZETO
Chief Assistant Secretary (1)4

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Mr Watson CHAN
Head (Research and Library Services)

Mr Jackie WU
Research Officer 1

Miss Augusta HO
Research Officer 4

Mr Joey LO
Assistant Secretary (1)1

Ms Christina SHIU
Legislative Assistant

I Confirmation of minutes of meeting and matters arising
(LC Paper No. CB(1) 1220/02-03)

The minutes of meeting held on 13 January 2003 were confirmed.

II Information paper issued since last meeting
(LC Paper No. CB(1) 1199/02-03 -- Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure)

2. Members noted that the paper listed above had been issued for members' general information since the last meeting.

III Date of next meeting and items for discussion
(LC Paper Nos. CB(1) 1343/02-03(01) and (02))

Regular Meeting to be held on Monday, 5 May 2003, at 10:45 am

3. The Panel agreed to discuss the following three items proposed by the Administration at the meeting:

- (a) Briefing on the work of Hong Kong Monetary Authority;
- (b) Briefing on the Clearing and Settlement Systems Bill; and
- (c) Consultancy Study on the Review of the Role of the Official Receiver's Office.

Meeting to discuss the Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure

4. The Panel agreed to hold a special meeting by end of April 2003 to discuss the Report. The Expert Group, representatives from the Administration, the Securities and Futures Commission (SFC) and the Hong Kong Exchanges and Clearing Limited (HKEx) would be invited to the meeting. Three alternative meeting slots on 28 April 8:30 am, 2:30 pm and 29 April 10:45 am were proposed. The Administration would be requested to co-ordinate the attendance of the other three parties for the meeting. It was also agreed that Mr Henry WU would liaise with those industry associations which considered that their views had not been incorporated in the Report to make written submissions to the Panel.

IV Briefing on the legislative proposals on the Companies (Amendment) Bill 2003
(LC Paper No. CB(1) 1133/02-03(06))

5. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)(DS(FS)) briefed members on the proposals to amend the Companies Ordinance (CO) (Cap. 32) to facilitate offers of shares and debentures, enhance shareholder remedies, define "subsidiary" for the purposes of group accounts, enable electronic incorporation and update the provision on partner limit. The Administration was drafting the above legislative amendments with a view to including them in the Companies (Amendment) Bill 2003 (the Bill) to be submitted to Legislative Council (the Council) in the 2002-03 session.

Discussion with members

Access to company records

6. Noting that the proposal allowing shareholders' access to company records might be subject to abuse, Mr Henry WU enquired about checks and balances to be put in place to address the problem. In reply, DS(FS) explained that as the order for inspection of records would be made by the court on condition that the applicant was acting in good faith and the inspection was for a proper purpose, sufficient checks and balances would be provided in the system.

Facilitation in the offers of shares and debentures

7. Regarding proposals to facilitate the offer of shares and debentures (i.e. paragraphs 6 and 7 of the paper), Mr James TIEN asked how investors would be protected against misleading or false information disclosed by companies on their business and performance in its marketing materials. In reply, Mr William PEARSON, Director, Corporate Finance, Securities and Futures Commission remarked that only factual and procedural rather than promotional information would be permitted in the issue of "awareness advertisements". Such advertisements would not constitute prospectuses nor prohibited advertisements under relevant securities laws.

Definition of "subsidiary" for the purposes of group accounts

8. In response to Mr James TIEN's question, DS(FS) explained that the definition of a subsidiary under section 2(4) of CO was narrower than those adopted in the International Accounting Standards (IAS) and the Hong Kong Statements of Standard Accounting Practice (SSAP), the Administration considered it necessary to amend the statutory definition to more closely align with them.

9. As to Mr James TIEN's enquiry about whether accounting rules and regulations would be changed accordingly to allow for the calculation of tax on a group account basis so that losses incurred by subsidiaries would offset profits of the parent company, DS(FS) confirmed that the proposed changes would not affect the present tax regime.

Reference to overseas experience

10. Mr Henry WU remarked that the approach of making reference to company laws of different overseas jurisdictions might result in inconsistencies in the legislation and cautioned against the piecemeal adoption of systems in overseas legislation. In reply, DS(FS) advised that the Administration's policy was to adopt the best practices of different overseas jurisdictions. In working out the current proposals on shareholder remedies, reference had been made to relevant legislation in Australia as it had a well-developed regime for protecting shareholders' rights. On the definition of subsidiary, reference was made to the IAS and UK Companies Act as the UK's accounting system and company law regime were similar to those in Hong Kong.

11. The Chairman opined that it would facilitate members in scrutinizing the Bill if the Administration would provide information comparing the legislation of overseas jurisdictions and the present proposals. He urged the Administration to provide the information when introducing the Bill into the Council.

V Enhancement of regulation of listed companies and corporate governance of companies

- (LC Paper No. CB(1) 622/02-03(01) -- Letter from Hon SIN Chung-kai on the regulation of listed companies
- LC Paper No. CB(1) 1343/02-03(04) -- Papers from the Administration
- LC Paper No. CB(1) 1343/02-03(05) -- Information note by the Research and Library Services Division of the LegCo Secretariat

Submission provided by organizations which had not attended the meeting

- LC Paper No. CB(1) 1343/02-03(06)-- Asian Securities Analysts Federation
- LC Paper No. CB(1) 1375/02-03(02)-- Morgan Stanley Dean Witter Asia Limited
- LC Paper No. CB(1) 1421/02-03(02)-- Hong Kong Securities and Futures Industry Staff Union)

Meeting with deputations and individuals

*Professor Stephen CHEUNG Yan-leung, City University of Hong Kong
(LC Paper No. CB(1) 1421/02-03(01))*

12. Professor Stephen CHEUNG gave a powerpoint presentation on the subject. In his opinion, a successful financial market depended on the existence of the right regulatory framework and quality listed companies and intermediaries. In his study on the performance of listed companies, he found that tougher initial public offering (IPO) requirements tended to result in better long-term corporate performance of the companies. He further remarked that a successful market hinged on the number of good listed companies, its liquidity and the ability to attract funds. In his study on connected party transactions, he found that there was clear evidence of expropriation of minority shareholders. In a bid to enhance corporate governance, it was important to enhance the independence of the board of directors. Other suggestions included licensing system for directors, strengthening director's education and enhancing the quality of intermediaries.

*Hong Kong Society of Financial Analysts Limited
(LC Paper No. CB(1) 1343/02-03(03))*

13. Mr James SOUTAR, Secretary of the Hong Kong Society of Financial Analysts presented the view of the Society. He remarked that enhancing corporate governance was the key to maintaining Hong Kong's position as an international financial centre. He was concerned that Hong Kong's pace in this respect had lagged behind its regional competitors. To rectify the situation, the Society proposed improvements in three major areas, including the composition and obligations of the board of directors, disclosure of information, and accountability of listed companies and their directors under the laws of Hong Kong.

*Mr David WEBB, WEBB-SITE.COM
(LC Paper No. CB(1) 1356/02-03(01))*

14. Mr David WEBB, Editor of WEBB-SITE.COM remarked that good corporate governance depended on incentives and deterrants. Currently, deterrants for financial malpractices, such as breaching of the Listing Rules, were minimal and amounted to nothing more than reprimands or public censures. In this connection, he supported the recommendation of the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure to provide statutory backing for Listing Rules and to have the Rules implemented by a single market regulator. He also proposed that a class action system by minority shareholders be put in place. On the hurdles to reform, he said that the existing arrangement whereby an overwhelming majority of the members of the Listing Committee of HKEx were issuers/advisors themselves who spoke for the same interest of the listing applicants had to be changed.

Hong Kong Society of Accountants
(LC Paper No. CB(1) 1366/02-03(01))

15. Mr David SUN, President of the Hong Kong Society of Accountants said that the Society recognized the important role of the accounting profession in enhancing the regulation and corporate governance of listed companies. In late January 2003, the Society submitted to the Administration a package of proposals for regulatory reforms in the accountancy profession. It was believed that these proposals would address the call for more transparency, independence and oversight of the accountancy profession in Hong Kong. The Society appealed for support of the Government, members of the Panel and the Council in passing the necessary amendments to the Professional Accountants Ordinance (Cap. 50) when they were introduced to the Council.

The Law Society of Hong Kong
(LC Paper No. CB(1) 1375/02-03(01))

16. Mr Simon LAI, Member of Company & Financial Law Commission of the Law Society of Hong Kong highlighted the Society's concerns on the subject, including the need for stepping up enforcement actions against malpractices of the company directors and intermediaries. He also stressed the importance of education on the duties of the company directors, particularly the independent directors.

Discussion with members

17. At the invitation of the Chairman, Secretary for Financial Services and the Treasury (SFST) reiterated the Administration's commitment to enhancing the regulation of listed companies and corporate governance of companies in Hong Kong. The Corporate Governance Action Plan presented to members in January 2003 set out the priority tasks being pursued by the Government, SFC and HKEx to improve corporate governance. For example, the Securities and Futures Ordinance (SFO), which contained provisions to enhance the transparency of listed companies and to combat market misconduct, had come into operation on 1 April 2003.

18. Mr Andrew SHENG, Chairman of SFC remarked that SFC had made reference to rules and regulations on corporate governance issues promulgated by relevant international organizations, such as the International Organization of Securities Commissions, the Organization for Economic Co-operation and Development, the International Monetary Fund in developing relevant standards in Hong Kong to ensure the best international practices were complied with. The SFC fully supported the Administration's Corporate Governance Action Plan and it was mainly involved in two priority areas, i.e. tightening the regulation of IPO intermediaries and the effective roll out of the SFO.

19. On the progress of HKEx in implementing the Corporate Governance Action Plan, Ms Karen LEE, Head, Listing, Regulation and Risk Management, HKEx remarked that HKEx would introduce amendments to the Listing Rules in the second quarter of 2003. The HKEx would complete streamlining of the listing process shortly and would issue guidelines to the sponsors stating the basic requirements of listing application documents. On tightening the regulation of IPO intermediaries, HKEx would consult the market jointly with SFC with the aim to implement the amendments in the second half of 2003.

Regulation of listed companies and appointment of independent directors

20. Mr James TIEN expressed concern that many companies had failed to meet business pledges they had made after their listing. He opined that company directors should not be the only party responsible for the problem, intermediaries including lawyers and auditors, etc also had a duty of care to the shareholders and the investing public. He urged the Administration to step up measures in enhancing corporate governance of companies.

21. On the appointment of independent directors, Mr TIEN was of the view that appointments should be made with regard to the persons' capability in helping the development of the company. He further opined that the proposal of "shareholders' democracy" might not be practicable in Hong Kong. As regards remunerations and bonuses of directors, Mr TIEN suggested that these should be determined by the independent directors to prevent conflict of interest.

22. In response, SEST took note of Mr TIEN's concerns and said that the issues would be dealt with in the consultation on the regulation of IPO intermediaries to be conducted by SFC and HKEx, which was part of the Corporate Governance Action Plan. The Administration fully recognized the importance of good corporate governance practices in building and enhancing Hong Kong's status as an international financial centre.

23. Mr SIN Chung-kai pointed out that given the recent incidents relating to false financial documents of listed companies, the Administration should expedite action in tightening regulation of listed companies and intermediaries. In reply, SEST re-affirmed the Administration's full commitment to enhancing corporate governance of companies in Hong Kong. He stressed that the Administration had been tackling the problem through implementing the Corporate Governance Action Plan. Moreover, the Independent Commission Against Corruption had been taking swift action against suspected malpractices of the company directors concerned. SEST assured members that the Administration was considering in collaboration with the Hong Kong Society of Accountants (HKSA) possible legislative amendments to the Professional Accountants Ordinance (Cap. 50) to enhance the self-regulatory regime of the accountancy profession.

24. On the subject of independent directors of listed companies, Ms Emily LAU asked representatives from organizations attending the meeting to suggest ways to attract qualified people to serve as such directors. She also asked Mr WEBB if he considered that conditions were ripe for Hong Kong to implement his proposal of "shareholders' democracy".

25. In reply, Professor Stephen CHEUNG remarked that as board chairmen of listed companies usually appointed close friends to be independent directors, the independence of such directors would be called into question. He suggested that there should be greater transparency in the recruitment process for independent directors. Moreover, it was appropriate to limit the number of companies a person would be allowed to serve as independent directors and the tenure of his office for the same company. Mr SOUTAR echoed Professor CHEUNG's views and believed that sufficient qualified people were available in Hong Kong to serve as independent directors. He opined that given the demanding nature of the job, independent directors should be adequately rewarded. Mr WEBB believed that the management of a company should not served as independent directors to avoid conflict of interest. On shareholders democracy, he supported a "one-share-one-vote" system. He remarked that financial intermediaries such as brokers and banks which held shares on behalf of the shareholders should be required to seek voting instructions from shareholders, as required by law in the United States.

26. Mr Eric LI opined that there was room for improvement in the current regulatory regime for listed companies which emphasized too much on sanction against misconduct. There had been concern among independent directors about shouldering the same legal liabilities as executive directors. This had deterred many well qualified people from serving as independent directors of companies. He suggested putting more efforts in providing training and incentives to the independent directors.

27. Mr NG Leung-sing opined that the success or failure of even the best system depended on the people who operated it. Hence, the integrity of the various stakeholders, e.g. company directors, sponsors, accountants, was crucial. He said the Administration and market regulators should consider introducing standards of integrity and monitoring systems to ensure the integrity of the stakeholders. In reply, SFST concurred with Mr NG's view and re-iterated the Administration's commitment to enhancing the corporate governance standards in Hong Kong to enhance Hong Kong's status as the premiere capital formation centre in Asia.

Role of Auditors

28. On Ms Emily LAU's enquiry about the role of company auditors in enhancing corporate governance and protecting shareholders' interests, Mr David SUN said that the role of the company management and the auditors were equally important. Mr WEBB remarked that the role of auditors had not been

adequately performed under the present system. He suggested that there should be an independent process in the appointment of company auditors. Mr SOUTAR supported the notion of having an independent audit committee to be appointed by independent directors to monitor the performance of a company.

Connected transactions and reporting of fraudulent practices by auditors

29. Mr HO Chun-yan enquired about measures to address the problem of unfair connected transactions and the propriety of statutory requirement for auditors to report fraudulent practices of a company. In reply, Professor Stephen CHEUNG said that connected transactions should be approved by independent directors. Moreover, new auditors should be appointed to a company every three or five years. Mr David SUN remarked that the guidelines and codes of practice issued by HKSA and provisions under the SFO had provided adequate safeguards against fraudulent practices. Mr David WEBB remarked that apart from the need to avoid appointment of independent directors by controlling shareholders, there was a need to revise the Listing Rules which currently did not require sufficient disclosure of corporate information. Moreover, SFC should step up its function in investigating suspicious transactions and corporate misconduct.

VI. Proposed amendment to the Resolution of the Land Fund
(LC Paper No. CB(1) 1343/02-03(07))

30. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Treasury) 2 (DS(Tsy)2) briefed members on the Administration's proposal to amend the resolution of the Land Fund to permit transfer of funds from the Fund to the General Revenue Account (GRA) in order to meet Government's expenditure requirements. As a result of the continued budget deficits in recent years, the balance of GRA was anticipated to have a shortfall soon. The Administration proposed to transfer part of the Land Fund to help resolve the cashflow requirements of the Government. The estimated balance of the Land Fund was \$259 billion by the end of March 2003. As shown in the 2003-04 Estimates, an estimated sum of \$120 billion was required to be transferred from the Land Fund for this purpose. DS(Tsy)2 advised that the Administration intended to move a resolution to amend the Resolution of the Land Fund at the Council meeting on 30 April 2003.

Regulatory mechanism

31. Mr NG Leung-sing remarked that as one of the trustees of the Hong Kong Special Administrative Region Government Land Fund during the period from 1988 to 1997, he was supportive of the Administration's proposal to transfer funds from the Land Fund to GRA to meet the budget deficits. He enquired if any mechanism would be put in place to govern the timing and circumstances under which any balance held in the Land Fund could be transferred to GRA. He also

enquired why the Administration did not envisage any major requirement for further transfer of fund in subsequent years of the projection period. He was concerned that there was no limit to the authority granted to the Financial Secretary (FS) for transferring fund from the Land Fund to GRA although the intention was for transferring \$120 billion only. There was also no stipulation in the resolution itself that the transfer of fund was to meet fiscal needs.

32. In reply, DS(Tsy)2 remarked that according to the latest Medium Range Forecast (MRF), the proposed \$120 billion to be transferred to GRA was sufficient to cover the cash flow requirement in the medium term. He advised that the need for further transfer of funds would be reviewed when the MRF was updated and the requirements for funds would be incorporated into the annual Estimates exercise and subject to the Council's scrutiny and approval.

33. Ms Cyd HO commented that the wording of the resolution resembled a "blank cheque" in that the FS may transfer any balance in the Land Fund which was not in his opinion required for the purpose of the Fund. She considered such sweeping powers unreasonable and might lead to abuse. DS(Tsy)2 explained that the proposed Resolution was aimed at bringing the Land Fund in line with the similar arrangements for other funds such as the Capital Works Reserve Fund, the Capital Investment Fund and the Loan Fund. There was already a mechanism in place for the transfer of such funds to finance shortfalls in GRA, i.e. through the annual Estimates exercise which was subject to the Council's scrutiny.

34. Given that the Land Fund had a specific source of income, Ms Margaret NG asked if there would be any mechanism to enable any unused portion of the fund transferred to GRA to be ploughed back into the Land Fund. DS(Tsy)2 explained that if the balance of the Fund had to be topped up in future, a further Resolution would be required for such a purpose.

Abolition of the Land Fund

35. Mr CHAN Kam-lam enquired about the reasons for the Administration's decision against abolishing the Land Fund to enable the balance to be freely utilized by the FS as part of the fiscal reserves. Ms Margaret NG remarked that the proposed resolution would be tantamount to a de facto abolition of the Land Fund as the FS would be empowered to transfer any balance in the Fund which was not in his opinion required for the purpose of the Fund.

36. In reply, DS(Tsy)2 stressed that the Administration's decision not to abolish the Land Fund was based on the belief that the Fund could still be used for a designated useful purpose in future. The proposed Resolution did not amount to a de facto abolition of the Land Fund, and that any requirements for further funds would be incorporated into the annual Estimates and subject to LegCo's scrutiny and approval.

37. As regards the long term use of the Land Fund, Mr NG Leung-sing enquired about whether the Administration would consult the public on the matter. In reply, DS(Tsy)2 remarked that currently, the Administration did not have plan to conduct a proactive consultation exercise. He emphasized, however, that the Administration would welcome suggestions from Members on the long term use of the Land Fund.

Balance of reserves

38. Mr CHAN Kam-lam asked about the projected balance of the fiscal reserves. Ms Emily LAU also enquired about the projected level of fiscal reserves as a result of the transfer. The Principal Assistant Secretary for Financial Services and the Treasury (MA) advised that according to the MRF, the balance of the fiscal reserves by the end of 2007-08 would be \$201 billion, a majority of which being the balance of the Land Fund. He agreed to provide supplementary information on the estimated sum to be transferred from the Land Fund, the projected balance of the fiscal reserves and statutory provisions on the use of accumulated surplus of the Exchange Fund.

39. Miss Emily LAU also enquired about the circumstances under which the accumulated surplus of the Exchange Fund could be used to meet operating and contingency requirements of the Government. DS(Tsy)2 remarked that there was a mechanism to enable the Financial Secretary to transfer from the Exchange Fund to GRA under the Exchange Fund Ordinance (Cap.66). The Ordinance, however, defined clearly that the Exchange Fund was to be used for safeguarding the exchange value of the Hong Kong dollar and maintaining the stability and integrity of the monetary and financial systems of Hong Kong. He agreed to provide more information in this respect.

(Post-meeting note: The supplementary information provided by the Administration was issued to members vide LC Paper Nos. CB(1)1405/02-03 and CB(1)1443/02-03 on 9 April and 14 April 2003 respectively.)

VII Any other business

40. There being no other business, the meeting ended at 12:54 pm.