

31st March 2003

To : The Legislative Council Panel on Financial Affairs

**Submission by the Hong Kong Society of Financial Analysts on
Enhancement on the Regulation on Listed Companies
and Corporate Governance of Companies**

Corporate Governance initiatives

The Hong Kong Society of Financial Analysts Ltd. is a not for profit association of Chartered Financial Analysts and CFA candidates. The society has roughly 2,000 members, and one of its key mission statements is to “To provide a convenient communication channel between financial analysts and investment advisors in Hong Kong and... Hong Kong securities market regulators.” Our Advocacy sub committee, comprised of 11 society members, and chaired by a director of the society has met to discuss the request of the Panel on Financial Affairs and we wish to comment specifically on ways we believe can achieve the stated goal of “upgrading the corporate governance of companies in order to restore investors’ confidence in the securities market.”

Corporate Governance

We believe corporate governance means the following:

Corporate Governance refers to processes and structures by which a company is directed, managed and controlled. It is important in any discussion of corporate governance to remember that it is the Board of Directors of a company that is legally responsible for directing the management of a company. The Board of Directors is obliged to act in the best interest of the company and all its stakeholders, including shareholders, employees and the community at large. It is important that any corporate governance framework assures that the board of directors is able to manage a company effectively and competitively, while also assuring that no inherent conflicts exist that would lead the Board to systematically favour one set of stakeholders over another.

With this broad definition of corporate governance in mind, we would like to make proposals in 3 areas: 1) the composition and obligations of the board of directors 2) public disclosure of information and 3) accountability of the company and its board under the laws of Hong Kong.

1) Composition and obligation of the Board of Directors

We believe it is imperative that the board be structured in such a way that conflicts of interests are minimized. We would recommend the following:

- That at least 1/3 of the board by number be made up of independent non executive directors
- That non executive directors be made up of individuals with a mix of skill sets appropriate to the company on whose board they serve
- That boards must form audit and compensation committees which are comprised of a majority of independent non executive directors
- That the audit committee be responsible for appointing external auditors and external property valuers etc.

- That both audit committee and compensation committee submit a report annually, to be included in the annual report and accounts, stating inter alia, that all external auditors etc were appointed independently and that no conflicts of interest exist with those appointments.
- That companies be made responsible for familiarizing independent non executive directors with the scope and risk characteristics of their business.
- That individuals be restricted to serving as non a executive director on a maximum of 6 companies in Hong Kong. Further, no individual should serve as an independent director on more than one company controlled by the same controlling shareholder.
- That Independent Directors tenure is limited to 2 years, at the end of which they may offer themselves for reelection at the annual general meeting of the company. Only minority shareholders should be able to vote for the reelection of non executive directors.

2) Disclosure

We believe that Hong Kong companies can improve their transparency. While we are aware that companies prefer to keep certain information private for competitive reasons, we feel that the following recommendations would not compromise competitive positioning.

- Directors remuneration should be disclosed on a person by person named basis annually.
- Attendance records of board meetings and audit and compensation committee meetings should be disclosed on an annual basis.
- Full beneficial ownership of greater than 5% of a company's shares should be disclosed on an ongoing basis.
- Unaudited consolidated P&L, Balance Sheet, Cash Flow and operating statistics should be disclosed on a quarterly basis
- A full valuation report of investment properties be made available upon request or posted on a company's web site, if a company has a web site
- Impairment testing of major assets should be conducted and disclosed on an annual basis
- As the share register is the ultimate determinant of whether shares have been issued, all registrars should be required to provide this information to the Stock Exchange of Hong Kong whenever new shares are issued. The Stock Exchange should then maintain, on its web site, a daily-updated list of all issues of listed shares in each company, and the date on which they were issued. A database with a web-based interface would do the trick. This should include the daily share buy-back data (after all, buy-backs are just negative issues) so that the net issued shares at any time are known.

We believe that companies should report in as timely a manner as possible. We would prefer to see companies report final results in a more timely manner than the current 3 month maximum, but understand that some companies would have difficulty complying with a shorter time frame. We do however, strongly feel that the current restriction on dealing by insiders of a company is far too lax. We believe that directors or other insiders should be banned from dealing in the shares of their companies from the last day of the reporting period to one day after they report their results. The current system of banning dealing in the one-month period prior to the announcement of results is inadequate and open to abuse in our view. Furthermore, we believe that no employee or director share options be granted within 5 days before or after the announcement of material price sensitive information by a company.

3) Accountability

We are very aware that a majority of companies listed on the Hong Kong Stock Exchange are incorporated overseas, and as such it may be difficult for Hong Kong based shareholders to pursue legal action against them. We feel strongly that companies that are listed on the Hong Kong Stock Exchange or that maintain a share register here in Hong Kong, and the directors of those companies should be accountable and able to be pursued under Hong Kong law for breached of corporate governance.

As we are not lawyers, we feel unqualified to offer legal solutions to this issue, but nonetheless feel that it is a key part of ensuring an improvement in corporate governance standards. We are aware that the Companies Ordinance has been under review for a number of years, and would suggest that that review be accelerated and that the issue of accountability under Hong Kong law be addressed in that review.

The above suggestions are by no means exhaustive in their scope, but we feel they form an excellent starting point in achieving the stated goal of upgrading the corporate governance of companies in order to restore investors' confidence in the securities market. The Hong Kong Society of Financial Analysts welcomes this opportunity to participate in this panel and looks forward to working with the Panel and the regulatory authorities to help improve local standards of Corporate Governance.

For and on Behalf of
The Hong Kong Society of Financial Analysts

A handwritten signature in black ink that reads "James A Soutar". The signature is written in a cursive style with a large initial 'J' and 'S'.

James A Soutar
Secretary