

**Speech by SFST at the Directors' Conference 2008**  
**organised by the Hong Kong Institute of Directors**  
**(English only)**

Wednesday, April 9, 2008

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, today (April 9) at the Directors' Conference 2008 organised by the Hong Kong Institute of Directors:

Moses (Cheng), Peter (Wong), distinguished guests, ladies and gentlemen,

It is my honour to give the closing address at today's conference on "Directors in the 21st Century".

Businesses and their directors face a lot of new challenges in the 21st century, be it increasing demand on efficiency and transparency, cost control, environmental concerns, or global competition. The distinguished speakers today have shared their thoughts on how to thrive in this new era of opportunities. I encourage you to bring the new ideas back to your businesses, to reflect on them, and to act on them as you see fit.

At the same time, I would like to urge you to reflect also on how Hong Kong, as an international financial centre (IFC), can meet the challenges of the 21st century. I would like to share with you my thoughts in this regard.

#### Importance of corporate governance

The sessions at today's conference, in one way or another, point to the critical importance of corporate governance in running a successful business. Strong corporate governance is also a key element in maintaining Hong Kong's position as a leading IFC.

Thanks to the joint efforts of business leaders including yourselves, professional bodies such as the Hong Kong Institute of Directors and financial regulators, we have come a long way in improving our corporate governance framework. In recent years, we have –

- \* strengthened our regulatory regime for the securities and futures sector through the enactment of the Securities and Futures Ordinance in 2003;
- \* introduced statutory derivative actions in 2004 to enhance protection of minority shareholders' interests;
- \* amended the Listing Rules in 2004 to require listed companies to have a minimum of 3 Independent Non-Executive Directors (INEDs);
- \* launched the Code on Corporate Governance Practices in 2005, which is benchmarked against best prevailing market practices and international standards and which included provisions on independence and accountability of the company management;
- \* set up Financial Reporting Council last July to further strengthen the oversight of auditors and financial reporting of listed companies; and
- \* also embarked on a major exercise to rewrite the Companies Ordinance. The purpose is to provide Hong Kong with a modernised legal infrastructure and to strengthen the existing corporate governance framework.

The improvements in corporate governance we have made have been recognised internationally, with Hong Kong being named amongst the forerunners in various corporate governance surveys.

As numerous academic research studies have shown, good corporate governance is good market valuation. Investors are prepared to pay more for buying companies that have good corporate governance. Our efforts in improving the quality of our markets and corporate governance standards have greatly enhanced the image of what listing in Hong Kong means to local and international investors.

Leveraging on other core strengths including the rule of law, clean government and deep pool of professional talents, we have greatly expanded the size of our stock market, and made it the premier capital formation centre for China. As at the end of February 2008, 439 Mainland enterprises have listed on our stock exchange, accounting for 35% of the total number of listed companies and 58% of our total market capitalisation. Indeed, the many Mainland firms that have listed in Hong Kong are in our market not only for raising the capital, but also for raising their corporate governance standards.

## Our regulatory focus

In our approach to regulating listed companies, our objective is to maintain the integrity and competitiveness of our market, and to provide our investors with an appropriate level of protection, but at the same time not to burden companies with undue compliance costs. In developing the corporate governance code for our companies, we have also taken into account of the unique characteristics of our economy so that we can be effective in dealing with specific problems our investors face in investing in our companies.

Over the years, as many of our companies have evolved from small and family businesses, the emphasis of our regulation is placed on the protection of minority shareholders' interests, and the conduct related to connected-party transactions. Our regulatory focus is also on infusing best practices into listed companies so that they serve as models for our Small and Medium Enterprises (SMEs), as well as to protect the investing public. Our regulators always strive to set a high level of world-class standards for our listed companies, be they local, from the Mainland or overseas.

In adopting the corporate governance code, we have always been mindful of the need to strike a balance between adhering to a high international standard on the one hand, and taking care of the local relevance on the other. Corporate governance is not simply a set of rules prescribed by some regulators and compliance can be checked by ticking boxes. Good corporate governance is a process of continuous improvement, and the culture and history of a market must be taken into account in designing a code that is practical and useful and above all, suits the needs of the market. For example, our corporate governance code tends to put more emphasis on regulating related-party transactions. At the same time, in terms of certain measures of the independence of the board, our corporate governance code may not be as prescriptive as that of some other international financial centers. Again, that is due to the predominantly family nature of local companies. It is important that our corporate governance code must fit the needs of our market, and there is no single set of universal code that will fit all economies.

This does not suggest that we should not look at what is happening in other jurisdictions to seek continuous improvement. Indeed Hong Kong has been making reference to international best practices in developing our corporate governance code. In corporate governance surveys we rank the best in Asia, and Hong Kong's companies have made good progress in terms of the independence of the board, disclosure, effectiveness of auditing and other board committees.

## International Listings

Now I will turn to the subject of Hong Kong as an IFC. As an IFC we seek to make Hong Kong an attractive listing platform for overseas companies. The Securities and Futures Commission and the Hong Kong Exchanges and Clearing Limited published a Joint Policy Statement Regarding the Listing of Overseas Companies in March 2007, to facilitate the listing of overseas companies in Hong Kong. And there have been on-going discussions in our market about what needs to be done to make our listing platform more attractive to overseas issuers.

Competition for the listing business has been becoming intense in recent years. Issuers are mobile and do have choices. The choice of where to list depends on an analysis of the benefits offered by a particular market (which includes liquidity, valuation and regulatory reputation), and the costs (listing costs, compliance costs, etc.) The success of the London market, which gives issuers access to different listing regimes with different requirements, illustrates the benefits of offering choices to issuers. The relative setback in the New York market after Sarbanes-Oxley, illustrates the costs of over-regulation.

The experience in these markets is food for thought for our discussion on how to make our listing platform more attractive to overseas issuers. Should we adopt a corporate governance code in our listing regime for overseas companies, different from the one offered to local companies here? For local companies I include both Hong Kong and Mainland companies for the reason that the financial markets of Hong Kong and Mainland are closely and increasingly interactive and our listing regime has been evolving to deal with companies from both economies. One argument in favour of adopting a different corporate governance code for overseas companies is that there is no one single code that can fit companies from very different economies.

Our experience in Hong Kong in developing good corporate governance practices illustrates this point. We have placed emphasis on connected-party transactions because of the dominance of family business in our economy. The evolution of our corporate governance practices is influenced by the international trend on the one hand, and practical issues related to our local as well as the increasing number of Mainland firms on the other.

The London example of having different listing regimes with different sets of corporate governance codes may provide a good reference for us. Having said this, obviously I don't mean to suggest that the London model would necessarily work for

us. In London, the primary listing status is given to companies that comply with a full set of corporate governance standards known as “super equivalence”. The secondary listing status, which is currently restricted only to non-UK companies, has a set of requirements that is referred to as “directive- minimum”. The London market also has a professionals-only market, and the AIM etc. Currently, the UK Financial Services Authority is launching a consultation to review the structure of its listing regime. One of the main questions in the consultation is whether there should be some streamlining and re-classification of different listing methods, in order to clarify what the label of UK listing means.

In thinking about our own listing regime, we should always keep in mind the important question of quality: what does the label of Hong Kong listing means? In designing a listing regime that is internationally competitive, we should always remind ourselves that our overall objective is to maintain the integrity and competitiveness of our market, and to provide our investors with an appropriate level of protection, without imposing undue costs on our issuers.

The questions for us to consider are - How to make our listing regime internationally competitive? How do we continue to protect and enhance the value of the listing status in Hong Kong? Although there may not be straightforward answers to these questions, I think we can strike the right balance by carefully studying our own practices as well as overseas experience. The dual goals of making our market competitive and upholding the quality of our market are not incompatible by themselves. This is because the long-term value of our market will be defined by how well we serve the investors as well as issuers, and whether listing in Hong Kong is good for firm valuation.

Closing remarks

Ladies and gentlemen, Hong Kong is rightly proud of our achievements as an IFC. As we move forward in the 21st century, we must ensure that good corporate governance continues to be embraced at all levels.

As our market and investors mature, we need to constantly review our regulatory framework. As we move to further develop Hong Kong into a market for international listings, we need to take a strategic assessment about long-term development of our capital market. Today I have raised some questions for you to consider, and I hope these will lead to active discussion among you, like the discussion that we have seen in today’s conference.

While we are considering the needs for the new market, let us not forget we should always seek continuous improvement for those who are listed here. I encourage listed companies to look beyond the mandatory requirements of the Listing Rules and the Code on Corporate Governance and seek to embrace the recommended best practices since good corporate governance is definitely not only a valuable asset of your companies but the market as a whole. For large private companies and SMEs, the Institute of Directors has put together two very useful Guidelines for Directors and Guidelines on Corporate Governance for SMEs in Hong Kong. I encourage you to review your operations and adopt the recommendations there as well as the best practices introduced by various speakers today.

Last but not least, I would like to commend the efforts of the Institute in organising today's conference and making it such a success in promoting corporate governance and in providing comprehensive corporate governance training for directors and senior management of companies.

Thank you.

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