

Speech

Speech by SFST at 7th Corporate Governance Conference of Hong Kong Institute of Chartered Secretaries (English only)

Friday, October 22, 2010

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the 7th Corporate Governance Conference of the Hong Kong Institute of Chartered Secretaries today (October 22):

Ladies and gentlemen, it is an honour to be asked by the Hong Kong Institute of Chartered Secretaries to speak at your biennial conference.

The theme of your conference, "Practical Corporate Governance: Disclosure and Transparency", I daresay is the factor that distinguishes a "great" company from the "good" ones. It is important to all companies irrespective of the businesses they engage in. It is also important to Hong Kong to maintain our position as a leading international financial centre.

Corporate governance as competitive advantage

Good corporate governance will enhance shareholders' value and ensure the entity is better run. It makes commercial sense. Investors, especially professionals, respect sound governance structure and are prepared to pay a premium for it.

Being branded a Hong Kong company is a quality assurance. The market thinks highly of our corporate governance standards. Mainland enterprises want to list on our exchange to demonstrate to the world that they have in place a very high corporate governance standard. On the other hand, international investors put money down in our markets because they are confident that companies are properly run. Good corporate governance is a way we can continue to add value and differentiate ourselves as a global financial centre.

Hong Kong approach

We appreciate that companies deal with a vast number of issues day-in day-out. Companies cannot operate by regulators looking over their shoulder and telling them how to handle every situation. Ultimately, the most successful corporate governance comes from the company adopting corporate governance as a "lifestyle" choice.

We believe corporate governance cannot be dictated line-by-line. Specific rules can only address scenarios anticipated at the time of making those rules. We cannot envisage every possible governance crisis that may arise. Besides, the same set of facts applied to different companies or even applied to the same company at a different point in time may call for a different way of handling it.

We have chosen to use standards that are based on principles and can be applied with flexibility. This differs from the "black letter law" approach exemplified by the Sarbanes-Oxley Act in the US.

Those seeking compliance with principles have more discretion on how they reach the standard. More often than not, it will result in more effective and meaningful corporate governance.

Generally speaking, we look to experiences from other jurisdictions when designing our own set of rules. But we also consult our market, including the corporations and the investing public, when we adopt major rule changes. This is to make sure that the changes best suit Hong Kong's conditions. The same goes for our corporate governance regulations where we have added our own tweaks to make them effective for our market, our companies, our culture and our business environment.

One particular feature about our economy that we need to recognise in designing our corporate governance regulation is the importance of family business. Like many emerging markets, or some established ones like the European markets, a significant proportion of our listed companies, and substantially all private companies, are family-run. The principal investors and managers are often family members or close friends. We need to take these factors into account when making the rules.

Family businesses have their merits. Management by family members normally has very long-term goals as they aim to keep their companies flourishing for the next generation and beyond. They tend to be more prudent in making investment decisions as they are spending their family fortune.

Family-run businesses tend to have a smaller minority stake in percentage terms. As a consequence, we have placed greater emphasis on transparency and disclosure in relation to connected party transactions as compared to other countries.

Companies Ordinance Rewrite

As you are aware, we are in the process for re-writing our Companies Ordinance (CO).

The CO provides the legal framework supporting the complete life cycle of companies. It governs how companies are "born"; the rules by which they play by while "alive"; and finally how companies meet their "death". Given the heavy responsibility on and the broad range of issues covered by the CO, it is not surprising that the CO is one of the longest and most complex piece of legislation, with over 600 sections and subsections and 24 schedules.

The CO dates back to 1932. On-going improvements have been made to the CO over the years, but a piecemeal approach to amending the CO has its limitations. It is generally recognised that a comprehensive rewrite of the CO is needed to modernise our company law in order to complement Hong Kong's role as a major international financial and business centre.

Like any significant legislative reform, the Government has to engage all relevant stakeholders to ensure that the new Ordinance will suit Hong Kong's needs. Public engagement helps make better policies, raises the quality of debate and help build consensus in our society.

We have taken over 10 years to consult on the CO and we will bring it to LegCo (Legislative Council) early next year.

The process is slow but it's worth spending the extra time and effort to get it right. As a global financial centre, our company law must have high and reputable corporate governance standards. At the same time, the rules cannot be over-stringent so as to stifle our business developments and innovation. A CO that strikes the right balance will allow Hong Kong to keep up with changes in our economic structure, technology and standards of corporate governance. By enhancing the brand of Hong Kong companies, it will help us reap the benefits from our status as an international financial centre.

The CO rewrite will enhance the overall corporate governance of companies. Accountability of directors will be strengthened by codifying the standard of directors' duty of care, skill and diligence. The law will clarify directors' duties and provide clear guidance to directors.

Transparency of companies will also be improved. Public and large private companies will be required to prepare a more analytical business review as part of the directors' report, covering environmental performance and employee issues as appropriate.

To deal with directors' conflict of interest, certain transactions will need to be approved by disinterested shareholders. This rule may be more stringent than the equivalent in other jurisdictions but we need it because of our widespread family-owned and run structure.

An equally important objective of the CO rewrite is to improve our business operation environment. We will introduce electronic incorporation and make changes to the company name registration system which will expedite the incorporation process. The time for incorporation can be reduced to one working day.

We will also reflect modern business trends and practices by facilitating companies to communicate with their members by electronic means and websites.

The exercise this time round will modernise the law, its language and re-arrange the sequence of provisions in a more logical and user-friendly manner.

Hong Kong as an international financial centre and the gateway to China has lots of overseas and Mainland investors using Hong Kong companies as investment and operating vehicles. Some jurisdictions require at least one local resident director, but having considered this, we came to the conclusion that this does not work for Hong Kong where we provide financial services to investors around the world.

We have embarked on the journey to rewrite the CO. The path may be long, windy and occasionally treacherous, but with the help of brilliant professional minds like yours, I am confident that we will complete our journey and achieve our objectives with flying colours.

Price sensitive information

Another important aspect of corporate governance is disclosure. Good disclosure practices enhance transparency and accountability. Transparency is necessary to enable the market to assess a company's position and thereby promotes investor confidence. You can see why good disclosure is essential for Hong Kong to sustain its position as the leading international financial centre and the premier capital formation centre in the region.

In the second quarter of this year, we conducted a public consultation on the proposed statutory codification of price sensitive information (PSI) disclosure requirements by listed corporations. We received 112 written submissions and I thank your institute for sharing your views by making a submission.

The respondents generally support the proposal and agree with our objective of enhancing market transparency and quality by cultivating a continuous disclosure culture among listed corporations. Our plan is to introduce a bill to the Legislative Council in this legislative session.

The new PSI regulations will create a win-win-win situation for the investors, listed corporations and their directors. Investors will benefit from a more transparent market. Listed corporations and directors should find the disclosure requirements clearer. The familiar concept of "inside information" will be used, safe harbours will be specified in the law and the SFC will promulgate detailed guidelines. In addition, the SFC will provide a consultation service for listed corporations in the initial period of implementing the statutory regime.

I would like to emphasise that we are not creating unnecessary burdens on you. But our new approach is devised to address the market's previous concerns about the lack of flexibility of statutory listing rules and, at the same time, making it clear to the market what needs to be disclosed.

We now have a proposal which can facilitate market compliance, encourage disclosure and provide quality information to investors.

Role of Company Secretaries

Company Secretaries have an important role to play in building the corporate governance culture. It is important that you provide advice and briefing to directors, particularly on compliance and governance matters. You channel information between directors and management, and engineer dialogue with outside parties such as investors and regulators. You are basically the control tower for information traffic.

The management of information flows has become increasingly important in recent years as the expectations for better corporate governance rise.

The proposed statutory codification on disclosure of price-sensitive information which I mentioned earlier has renewed focus on company secretaries' role in promoting transparency of a company. The directors will lean on you to provide sound advice in assessing what amounts to price sensitive information and to prepare appropriate announcements. You will also need to remind directors and management not to inadvertently leak information before an announcement of PSI.

In this regard, it would be important for company secretaries to be familiar with the company law and listing rules and keep up with the latest developments on the regulatory front. We very much appreciate the institute for running CPD programmes to help company secretaries better equip themselves for their challenging jobs.

Conclusion

Both corporate governance and disclosure are very important in consolidating and promoting Hong Kong as an international financial centre. If we do it right and do it well, it will attract businesses to set up here and also investors arriving with capital looking for investment opportunities.

Thank you very much.

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