Hong Kong Institute of
Certified Public Accountants
香港會計師公會

HKICPA makes corporate governance recommendations, advocating for a strengthened capital market

(Hong Kong, 2 May 2018) The Hong Kong Institute of Certified Public Accountants (HKICPA), following an extensive study on corporate governance in key markets, has called for substantial improvements including the establishment by the Government of a high level policy unit; the strengthening of the role of independent non-executive directors (INEDs) to hold corporate boards accountable; and to bring more board actions into the enforcement regime of Securities and Futures Ordinance.

These are some of the wide ranging recommendations based on findings in the *Report on Improving Corporate Governance in Hong Kong*, a HKICPA-commissioned, independent comparative study of corporate governance regimes across Hong Kong, the UK, the US, Mainland China and Singapore, with a particular focus on shareholders' rights, remedies and protections, and the regulation of non-Hong Kong incorporated companies.

"Hong Kong has largely kept up with international developments over the past two decades. However, incremental and reactive changes are no longer enough for Hong Kong to stay ahead as a global player; we need significantly more," said Mr. Wong Kim Man, convenor of the HKICPA Corporate Governance Working Group.

"The Government must take the lead in instigating significant changes in some fundamental areas if Hong Kong is to stay ahead as a competitive and well-regulated international financial hub that balances the needs of business development and investor protection," he said.

While the study, carried out by Syren Johnstone and Say H. Goo of HKU's Asian Institute of International Financial Law, found that Hong Kong's corporate governance system is on a par with international best practices in many areas, including its statutory law, non-statutory listing rules and codes, and gateway mechanisms for new listings. In order to enhance Hong Kong's attractiveness to investors, certain recommendations made by the consultants in three key areas should receive more immediate attention; namely:

1. *<u>Corporate governance architecture and policy</u>*

The Government should establish a high level "Corporate Governance Policy Unit" to lead and coordinate policy formulation for a strong corporate governance framework. There also needs to be a discussion among stakeholders as to the overarching objectives that should drive the development of the Hong Kong market.

"The global financial markets are very competitive, and market integrity is key to investor confidence which can be boosted by sharpening Hong Kong's edge in corporate governance," said Mr. Raphael Ding, Chief Executive and Registrar of HKICPA.

"In practice, this means that we need new ideas and new measures to ensure that in the face of rapid market developments, our investor protection and governance models remain robust and effective. The study defines corporate governance in terms of five fundamental aspects - information, involvement, equality, accountability, and effectiveness; and the recommendations are derived from considering these essential elements of good governance."

2. *The Board*

Independent non-executive directors (INEDs) have a vital part to play in board effectiveness and accountability. The framework around the role and responsibilities of INEDs should be strengthened, as there are significant expectation gaps that need to be addressed. The HKICPA recommends that:

- The board's corporate governance report should include specific statements on how INEDs have discharged their role and responsibilities. A lead INED should be appointed to oversee such reporting.
- Audit committees should make a separate, direct disclosure in the annual report on the work that they have performed, instead of reporting indirectly via the board. This should also be overseen by the lead INED.
- A code for Non-Executive Directors (NEDs) should be developed by listed companies on a comply-or-explain basis. This would help investors evaluate the role that companies expect their NEDs, and in particular their INEDs, to fulfil and how effective they have been in performing that role, and in upholding good corporate governance and ensuring that the board remained accountable.
- The board should consider the linkages between INEDs' work, expected time commitment and responsibilities, and their remuneration, and an appropriate disclosure should be made in the corporate governance report.
- Reflecting their importance to investors and their standing in the market, Hang Seng Index companies should be required to adopt higher corporate governance standards on a comply-or-explain basis.

"Importantly, these measures will underpin the proper role of INEDs on boards and their value in safeguarding investor interests, as well as working in the long-term interests of the company. When institutional investors and corporate boards appreciate this, the demand for and calibre of INEDs will only improve, creating a positive, upward spiral of corporate governance enhancements," said Mr. Ding. "Hopefully, this will also discourage those who see INEDs as being there for window dressing and independent in name only from taking up the role."

3. *Enforcement*

When the study looked at the quality of disclosures of information important to investors, and the potential repercussions of inadequate or inaccurate disclosures, it found gaps in enforcement options available to regulators and shareholders in Hong Kong compared with the other markets studied. The study also highlights the need for more effective cooperation and enforcement by regulators on a cross-border basis. The HKICPA recommends that:

- Listed companies should be required to disclose any material breaches of listing rules and the steps taken to address these on an ongoing basis, as well as making an annual certification of the position.
- Corporate governance disclosures and facts stated in INED statements of their independence should be brought within the statutory regime governing the provision of false or misleading information to regulators (i.e., section 384 of the Securities and Futures Ordinance, Cap. 571).
- The SFC should be given more graduated sanctioning powers, such as the power to fine a company as a warning-cum-precursor to directing the suspension of trading (i.e., under the Securities and Futures (Stock Market Listing) Rules, Cap. 571V). This will also benefit investors and the market as a whole by potentially averting more drastic action.
- The role of the compliance adviser in newly listed companies should be extended to cover a wider range of corporate governance-related processes, and should be taken up by an IPO sponsor.
- The government should explore with the Mainland authorities expanding the existing arrangements for reciprocal recognition and enforcement of non-criminal court judgments on specific matters relating to listed companies, their officers and other relevant parties.

Based on the market comparisons, the report puts forward a wide range of recommendations. The HKICPA is proposing that a number of these be taken forward as priority items.

"While we expect that more discussion and debate will be necessary in order to agree on detailed changes, the HKICPA is ready to work with other stakeholders to facilitate further progress in Hong Kong's corporate governance development," says Mr. Ding.

The full report and recommendations are available at https://bit.ly/2KhYN3B .

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About HKICPA

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the statutory body established by the Professional Accountants Ordinance responsible for the professional training, development and regulation of certified public accountants in Hong Kong. The Institute has more than 42,000 members and 18,000 registered students.

Our qualification programme assures the quality of entry into the profession, and we promulgate financial reporting, auditing and ethical standards that safeguard Hong Kong's leadership as an international financial centre.

The CPA designation is a top qualification recognised globally. The Institute is a member of and actively contributes to the work of the Global Accounting Alliance and International Federation of Accountants.

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