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June 2019

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The journal of The Hong Kong
Institute of Chartered Secretaries
香港特許秘書公會會刊



Board
governance
The art of
decision-making
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The Hong Kong Institute of Chartered Secretaries (HKICS) is an independent professional body dedicated to the promotion of its members' role in the formulation and effective implementation of good governance policies, as well as the development of the profession of the Chartered Secretary and Chartered Governance Professional in Hong Kong and throughout Mainland China. HKICS was first established in 1949 as an association of Hong Kong members of The Institute of Chartered Secretaries and Administrators (ICSA) of London. It was a branch of ICSA in 1990 before gaining local status in 1994 and has also been ICSA's China/Hong Kong Division since 2005. HKICS is a founder member of Corporate Secretaries International Association (CSIA), which was established in March 2010 in Geneva, Switzerland. In 2017, CSIA was relocated to Hong Kong where it operates as a company limited by guarantee. CSIA aims to give a global voice to corporate secretaries and governance professionals. HKICS has over 6,000 members and 3,200 students.

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Mastering the art of good decision-making

This month our journal looks at one of our profession's toughest assignments – facilitating effective decision-making by the board. Tough though this assignment may be, it is also endlessly fascinating, involving both the personal dynamics of the cast of characters involved in board decisions and the history that has built up the 'culture' unique to every board.

There is no shortage of advice out there, of course, about the art of building and maintaining an effective board of directors, but most of it focuses on issues such as the chairman/CEO relationship, board structures, the roles of independent directors, etc. These are important issues to consider, but our cover story this month looks at the problem from the perspective of the company secretary, who, as the article points out, 'is uniquely involved in both the highest-level strategy issues, and the minutiae of board and company administration – the latter being just as important as the former'.

That last point is of importance. When in search of the elusive quality of good decision-making, the administrative details can be critical. Where should the board meeting take place? How long should the meeting be? What should be included on the meeting agenda? What information should be included in the board papers? How should the discussion be structured?

A lot more hangs on these details than one might suppose, and our cover story this month gathers insights from senior members of our profession on these and other aspects of the company secretary's board support work.

One matter to emerge from the article is just how varied board practices are. Different boards find different ways of addressing the key obstacles to good decision-making and our cover story is a trove of excellent ideas for best board practices that you are unlikely to find in a manual. Off-site board meetings in a different jurisdiction from the usual one, for example, enable directors to meet local, lower-level managers and get closer to the company culture on the ground. The chairman's lunch held the day before the formal board meeting is another example, giving directors the opportunity to talk through relevant discussion points informally. These may or may not work for your board, but our cover story this month will certainly be a good primer for members of our profession hoping for advice on this complex but intriguing aspect of the company secretarial function relating to boardroom dynamics.

Before I go, I would like to thank everyone involved in our 20th Annual Corporate and Regulatory Update

(ACRU), which was held on 5 June at the Hong Kong Convention and Exhibition Centre (HKCEC).

On behalf of the Institute, I would like to thank the regulatory bodies who participated in ACRU this year: the Companies Registry, Hong Kong Exchanges and Clearing Ltd, the Mandatory Provident Fund Schemes Authority, and the Securities and Futures Commission. I would also like to thank Edith Shih FCIS FCS(PE), International President of The Institute of Chartered Secretaries and Administrators (ICSA) and Past President of HKICS, together with Mark Hughes, Partner, Slaughter and May, Hong Kong, for their contributions to our innovation session this year – the 'Practitioner Practical Sharing' session.

Thanks are also due to our sponsors, the panel Chairs, our Institute's Secretariat, student helpers, the conference organiser and the staff of the HKCEC for their hard work in putting together a highly successful seminar for the 20th anniversary of our ACRU series.

A handwritten signature in black ink, appearing to read 'David Fu', with a stylized flourish at the end.

David Fu FCIS FCS(PE)

掌握良好决策的艺术

本刊今期探讨特许秘书和管治专业最艰巨的任务之一：促进董事会作有效决策。任务尽管艰巨，体验却奇妙无比，涉及参与董事会决策的各人的互动，以及形成每个董事会的独有「文化」的历史。

有关建立和维持有效的董事会的艺术，坊间当然不乏种种建议，不过大部分集中讨论主席和行政总裁的关系、董事会架构、独立董事的角色等课题。这些层面固然重要，但今期的封面故事从公司秘书的角度探讨这问题。正如该文所指出，公司秘书「角色独特，既参与最高层的策略性事项，又兼顾董事会及公司行政的细节；而后者与前者一样重要」。

最后一点十分重要。良好决策的特质难以捉摸，行政细节可以是关键所在。董事会会议应在哪里举行？会议时间应有多长？议程应包括甚么？会议文件应包括什么资料？讨论过程应如何安排？这些细节远比想像中重要，今期的封面故事由公会资深会员分享这方面的体会，

以及公司秘书在支援董事会的工作上其他方面的体验。

从文章的内容可见，不同的董事会以不同方法处理有碍良好决策的主要障碍；该文胪列多项最佳做法，这是难以在公司秘书手册找到的。例如离开惯常的开会地点，到另一地区开会，可让董事与当地基层管理人员见面，实地了解公司文化。另一例子是由主席在正式董事会会议前一天邀请董事午餐，让董事有机会非正式地谈论相关的论点。这些方法也许对你的董事会有帮助，也许没有，但公司秘书若希望得到指引，协助处理有关董事会互动这项复杂而有趣的职能，今期的封面故事肯定是很好的入门指南。

最后，第20届公司规管最新发展研讨会(ACRU)已于6月5日在香港会议及展览中心举行，我谨向所有参与的人士致谢。

我谨代表公会感谢今年参与ACRU的监管机构，包括公司注册处、香港交易及结算所有限公司、强制性公积金计

划管理局，以及证券及期货事务监察委员会。我亦感谢特许秘书及行政人员公会(ICSA)国际会长兼公会前会长施熙德律师FCIS FCS(PE)，以及香港司力达律师楼合伙人Mark Hughes律师，他们参与了我们今年新设的「从业员实务交流」环节，分享宝贵经验。

我亦感谢各赞助机构、专题讨论主持人、公会秘书处、学生助理、活动策划公司，以及香港会议及展览中心的职员；全赖他们辛勤工作，第20届ACRU才得以成功举行。

傅溢鸿

傅溢鸿 FCIS FCS(PE)

Board governance



CSj highlights the company secretary's unique perspective on the factors that contribute to effective decision-making by the board.

You have put together a stellar cast of directors, and both shareholders and management are content, but before you know it, there are murmurs of dissatisfaction and rumblings of discontent. Personality clashes and rival agendas are splintering your board, and crucial policies are threatening to unravel.

One factor which can help to avert this dismal scenario is having a professionally qualified company secretary to act as an anchor, playing a unique role in holding together board discussions, boosting board morale, enhancing its efficiency, teasing out the best policy decisions and safeguarding governance standards. Let us go then behind the scenes into the world of the company secretary to learn about the challenges they face and their unique contribution to quality decision-making by the board.

Director inductions

Philip Miller, FCIS FCS, Deputy Corporation Secretary, The Hongkong and Shanghai Banking Corporation Ltd (HSBC), points out that the company secretary plays a major role in helping new directors join the board with a tailored structure of induction meetings and briefings. An effective induction helps directors meet everyone they should know and understand how the business operates. He adds that inductions help directors get an understanding of the key growth drivers for the business, the environment relevant to the company and the risks to the business, particularly if it is an industry that is not their principal area of expertise.

Gillian Meller FCIS FCS, Legal and European Business Director and Company Secretary, MTR Corporation Ltd (MTRC), echoes Mr Miller in that the induction gives directors, firstly an understanding of the strategy of the business itself, and secondly a reminder of their duties and responsibilities. Interestingly, she adds a third element to this, since the company secretary can also play a pragmatic role explaining to directors how things get done and how the board works from a practical perspective. For example, how often do directors speak up at meetings and how often is a consensus reached?

'If you cover these three elements, the strategy of the business, the responsibilities of directors – including their obligations and liabilities – and the boardroom dynamics, that will give a director a good start,' Ms Meller says.

Informal conversations

Should a company secretary be cognisant of conversations that take place on the golf course? Mr Miller of HSBC accepts that there will be many

informal business conversations, but points out that formal governance is the remit of the company secretary.

'One is looking at the formal governance framework the company has in place,' he says, 'the board, its meetings and committees, or perhaps delegation of authority therefrom. This is what the company secretary should be focused on.' He adds that, if the discussions are of consequence, proper governance would require them to be accurately described and recorded in board minutes, thus placing them within the remit of the company secretary and the value that he/she can add.

The MTRC meanwhile has a novel approach to the golf club quandary – the chairman's lunch. This is held the day before the formal board meeting, giving directors the opportunity to talk through relevant discussion points informally. This gives directors the chance to ask questions and think through any particularly challenging issues, making them better prepared for the formal meeting the next day.

Highlights

- many aspects of the company secretary's board support role play a critical role in facilitating effective decision-making
- the company secretary, together with the chairman, needs to create the right environment for the views of directors to be heard and properly minuted
- familiarising directors with layers of management below the most senior level can provide them with valuable insights into the culture that pervades in the company

The minutes and board agenda

The company secretary is uniquely involved in both the highest-level strategy issues, and the minutiae of board and company administration – the latter being just as important as the former. Taking minutes and structuring the board agenda, for example, have a direct impact on board efficiency.

Setting the agenda, Mr Miller points out, requires the company secretary to engage with the chairman to get a clear agreement on what should be on the agenda, and with management to ensure they know what information they should be providing. The chairman, of course, has the key role to create an open engaging environment where frank discussions and honest conversations can take place. Where directors disagree with something, they should feel free to raise their objections.

The company secretary makes that possible in practice, however, through the structure of the agenda and ensuring that the correct information flows up to the board. The company secretary's role in ensuring a correct format and structure of the meeting to facilitate detailed discussion, where appropriate, is crucial – simply having an opportunity for question time on key issues, for example, can make a huge difference to board outcomes.

Similarly, despite the great advances that technology has made to the art of minuting, the company secretary still plays a crucial role in correctly recording the various points of view of board members, and whether a fair and evaluative discussion has taken place. This is particularly important when there is conflict of opinion within the board – the minutes may need to record, for example, where dissenting opinions were raised.

Information flow

The most critical risk for a director is not receiving appropriate information to make an informed decision. This is particularly important with regards to information flow from committees to the board. Though board members routinely receive minutes of committee meetings circulated in advance of board meetings, there is the real risk that the sheer volume of paperwork will mean that vital information may be missed or not fully understood.

Ms Meller shares some tips on how to get around this dilemma. Though proceedings of board committee meetings need to be properly minuted and distributed, it can be helpful to prepare what she refers to as 'proceedings'. These 5- to 10-page summaries of the committee meeting discussions can be a useful way to enhance understanding of the key issues raised.

Linking board and management

A seemingly obvious, but often overlooked, issue for company secretaries in their board support work is the task of ensuring that there is a strong relationship and understanding between directors and the management team. Mr Miller believes the company secretary can play an important role in helping to facilitate honest and meaningful discussions, not just between directors and senior management, but also the levels below that.

'Familiarising directors with layers of management below the most senior level can provide them with valuable insights into the culture that pervades in the company', he says. 'It is not a precise science, but the company secretary does inevitably play, or should play,

an important role in supporting both directors and management, not getting between them, but helping facilitate their engagement and valuable interaction. In simple terms, this helps to make sure that directors are getting the quality of information they require for proper decision-making at the board level.'

To achieve this, the company secretary needs to be proactive. In the normal course of things, reporting to directors will usually come from very senior individuals, so the company secretary should look for opportunities where directors can engage with the next management level down. This might be achieved by delegating reporting on an ad hoc basis to lower levels of management where the specific expertise may actually lie, but this does require assent by the directors as they may need to take time out to meet with these individuals separately. There may be arrangements, for example, for off-site board meetings. A meeting in a different jurisdiction from the usual one would be a good opportunity for directors to meet the local team and for providing the management on-the-ground with the opportunities for interaction.

Avoiding groupthink

Groupthink, where board members fail to challenge a false consensus, is precisely what a proper board exists to avoid, but it is all too easy for the perceived 'experts' running the show to dominate discussions. A well-functioning board with independent and competent directors should be balanced in its approach while weighing different perspectives. The balance of power on the board can play a key role in the quality of discussions. It may be axiomatic that independent directors should have a voice that is not

“
the company secretary is uniquely involved in both the highest-level strategy issues, and the minutiae of board and company administration – the latter being just as important as the former
”



overwhelmed by executives. The company secretary has to ensure that the structure of meetings allows adequate time for potentially contentious discussions, and that, together with the chairman, the right environment is created to enable the views of independent directors to be heard and properly minuted.

Guiding the nomination committee

As mentioned above, boards should not be dominated by executive directors. This is particularly true of board committees, such as the nomination committee, which needs to have an independent approach. A key factor here is to have a chairman with a strong personality who will not be subservient to any executive directors on the committee, but the company secretary can also play an important role in protecting the committee's independence. This might be achieved, for example, by ensuring that the different views of committee members are channelled back to the board.

Should company secretaries have a role to play where they perceive

that an independent director has lost independence but remains designated as such by the board? 'Absolutely', Ms Meller says, 'I think the first thing I would do is have a conversation with the chairman to talk him or her through the independence criteria and how the position may have changed. Then there would need to be a discussion either at the board or the nomination committee to come to an understanding of the issues.'

Ms Meller adds, however, that one should not assume that a non-executive director who cannot be deemed 'independent' will be too aligned with management. Some non-executive directors are appointed by shareholders and do not come from the ranks of management, as is the case with the MTRC.

Board evaluations

The nomination committee may have a broad enough perspective to determine the skill sets of board members and the expertise that may be lacking on the board, but it may itself not have the perspective to determine the strength and weakness of

the board as a whole. This is especially true if business challenges on the horizon are coming from startups that existing board members are not familiar with.

Is it essential, then, for a third party to conduct board evaluations? Ms Meller feels that this depends on the type of internal or external evaluation that is carried out. Internal evaluations can be critical if one moves away from sending out a questionnaire with yes or no answers to something deeper and more searching. It may be tricky for a company secretary to sit down with board members and get them to be completely open because they may be seen to be too critical. But equally, 'washing your laundry in-house' might actually encourage board members to be more open. Conversely, members might also be more inclined to open up to a third party. She suggests that perhaps a combination of internal and external reviews, as is required in the UK, may make sense.

Sharan Gill
Journalist



Protecting market integrity

Tim Lui Tim-leung SBS JP, who took up his current role as Chairman of the Securities and Futures Commission (SFC) in October 2018, discusses the importance for the future of Hong Kong of protecting market integrity and promoting high standards of corporate governance.

What are your aspirations in the role of SFC Chairman?

'My key aspiration is to maintain Hong Kong as one of the world's leading international financial centres. It is important that we maintain the highest market integrity and an open and transparent market, because financial services is one of our key strengths and core areas.

Hong Kong is Mainland China's international financial centre. We have to maintain that status and consolidate and reinforce our position. So my role at the SFC is to push hard on that front, to foster market integrity, and make sure we have a clean and efficient market backed up by high international standards of regulation. Our regulatory practices should stay ahead of the times by keeping up with global developments. We also need to adapt international best practices to the local environment.'

We have seen some developments in Hong Kong, permitting weighted voting rights for example, which seem to be aimed more at boosting the competitiveness of the local market rather than maintaining high standards – is it hard to find the right balance between these two goals?

'At the SFC we look at regulation and market development as interrelated. We must stay competitive, but not compromise our standards. Taking the example of weighted voting rights (WVR), the US has had WVR companies for many years, so it's not something new, but we are the first jurisdiction to have the regulatory controls mapped out more formally.

From our perspective, high-tech and biotech companies are businesses of the future and there needs to be space within

the capital market to cater for them. So last year we agreed to the new listing regime that allows WVRs with the Hong Kong Stock Exchange (the Exchange). We need to move with the times, but only as long as we are satisfied on the regulatory front that we are not compromising standards just for the sake of grabbing market share.'

In 2016/2017, the SFC launched its front-loaded approach to regulation – nearly three years on, do you think that the new approach is having the desired effect?

'The front-loaded approach came from discussions between the SFC and the Exchange back in 2016. As the name suggests, the front-loaded approach is all about getting in there earlier, identifying the issues and dealing with them promptly to enhance investor protection. It is also about stamping out systemic risks and threats in the market.

The front-loaded approach can be split into a few component parts. First, it relates to the way we get directly involved at the initial stage of vetting IPOs. If we think an IPO application looks fine, we leave it to the Exchange to handle. But where we have concerns, the applicant needs to address them. If those concerns cannot be addressed, we will object to the listing for the best interests of Hong Kong.

This approach also relates to corporate transactions and other post-IPO issues. In our 2018 fiscal year, we intervened about 46 times – 19 of those were IPO cases but the rest were post-IPO cases where we may have concerns about excessive dilution of the shareholding, undervalued or overvalued acquisitions, or about placements going to parties that are acting in concert. Some companies decided not to proceed with the proposed transactions after we intervened.

We have also prioritised serious cases – situations where there has been market misbehaviour and the reputational risk to the market is high – because they cause the most damage to Hong Kong. There have been reports in the press recently about networks of listed companies, warehousing, backdoor listings and the use of shell companies – these are all concerns for us. We have finite resources here, but when we identify something that is serious or systemic, we put our resources into dealing with it'

How successful do you think the current working relationship is between the SFC and the Exchange?

'The Exchange is doing a lot in terms of listing regulation, but it may have some inherent or perceived conflicts because it is also a commercial business. That's why

Highlights

- the SFC's role in maintaining the integrity of Hong Kong's financial markets is critical for the city's future
- high-tech and biotech companies are businesses of the future and there needs to be space within the capital market to cater for them
- Chartered Governance Professionals and Chartered Secretaries can have a huge impact by influencing their companies' corporate governance culture

the SFC has oversight and a regulatory role performing annual audits of the various functions of the Exchange. That some form of tension exists in the regulator/regulatee relationship is only natural, but there is a high level of cooperation and a lot of dialogue between our people.'

Can we talk about regulatory cooperation – both globally and with Mainland China?

'We are very fortunate that our CEO, Mr Ashley Alder, is in his second term as Chairman of the board of the International Organisation of Securities Commissions (IOSCO). We are involved in IOSCO discussions, and participate extensively in the work of the Financial Stability Board and many other international forums where we are well represented. That reaps a lot of benefits for us, as we hear first-hand about the concerns of our counterparts all over the world, particularly where they see the greatest emerging risks. We can then assess how we should manage and mitigate those risks here in Hong Kong.

Our cooperation with the Mainland is also a big part of our work. More than half the companies listed on the Exchange have a Mainland linkage, and we deal with our Mainland counterparts in relation to a lot of our regulatory work. Over the years we have built up a very good relationship with the China Securities Regulatory Commission (CSRC). We have set up a Mainland Affairs team, which helps improve dialogue with the CSRC and other regulatory bodies on the Mainland.

Our people meet regularly, in fact we have a senior personnel meeting biannually – the latest one took place in

May. When I was up in Beijing in March, I had the opportunity to meet with the new CSRC chairman, who took office in February this year. We shared a common vision to make sure our markets are clean and foster more investor protection. To do that, there needs to be cooperation and dialogue between both parties.'

Do you think in the future the SFC will be moving to coordinated supervision with the CSRC?

'This matter could be explored further down the road, but our people are in contact with the CSRC regularly. If we need to take evidence from individuals residing in the Mainland, we enlist the help of the CSRC. This is working well, particularly in terms of obtaining evidence in civil actions. We have signed numerous memoranda of understanding with the CSRC covering a lot of supervisory and enforcement issues.'

Significant differences remain between the capital markets and the regulatory philosophies of Mainland China and Hong Kong – are there limits to how far market convergence and regulatory cooperation can go?

'Markets might operate differently, but the SFC and the CSRC are regulatory bodies and our aims and objectives are virtually identical. We are trying our best to make sure we effectively combat market misconduct and fraud, maintain the integrity of the markets and protect investors' interests. So, from that perspective, the CSRC and the SFC look at the regulatory landscape through the same lens.'

Do you think Hong Kong needs to raise its game where corporate governance is concerned?

'In the CG Watch 2018 report, published

“
my key aspiration
is to maintain Hong
Kong as one of the
world’s leading
international
financial centres

”

by the Asian Corporate Governance Association (ACGA), Hong Kong ranked second only to Australia in Asia, so I don't think we are lacking in any sense. Of course you can always improve, and that is why the Hong Kong Institute of Chartered Secretaries, the Hong Kong Institute of Certified Public Accountants (HKICPA), the Hong Kong Institute of Directors and other organisations are pushing very hard on the promotion and development of corporate governance.'

What would be your message for Chartered Governance Professionals and Chartered Secretaries in terms of the role they can play in raising governance standards?

'Chartered Governance Professionals and Chartered Secretaries play a big part in raising governance standards because they are there on the ground. They know where the soft side of corporate governance is, so they can instil the culture and mindset for corporate governance much more effectively. They can have a huge impact. They give advice to the board of directors and management and, if they do their jobs diligently and properly, they can influence their companies' corporate governance culture and business performance.'

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16
September

Stakeholder Networking Luncheon

17
September

Corporate Governance Forum

18-20
September

Enhanced Continuing Professional Development Seminars, Lanzhou, Mainland China

21
September

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Technology is transforming our capital markets and the nature of regulation. What's your view of how the SFC should respond to these changes?

'Whatever we do, we do it very much based on principle – we are technologically neutral in that sense. We don't stand in the way of technological advancement. We accept that technology has a big part to play going forward, but we need to make sure there are adequate controls and safeguards in place.

Internally we also need to stay ahead of the curve by deploying more technology, both in our enforcement and licensing work. We also upgrade our technology to help us carry out our work more efficiently. In a nutshell, IT is here to stay and we intend to make the best use of it.'

The advent of machine learning and artificial intelligence means that more decisions are being made automatically – is this a problem for the SFC's enforcement of individual accountability?

'The use of technology does not mean that the relationship between the SFC and the firms that we supervise needs to change dramatically, because we are still looking to the Responsible Officers (ROs) as the persons who are accountable. The RO would have to be satisfied that the technology complies with the regulations and is not going to subject the firm to excessive risk.'

There is a lot of interest from readers in the personal background and career path of our 'In Profile' interviewees – can you tell us about your own background?

'After obtaining an MBA in the UK, I joined what was then the largest international accounting firm in London,

Coopers & Lybrand (C&L). I started in audit, like everybody else, and later I moved to taxation, which I found to be more challenging.

I came back to Hong Kong in November 1984 and became a partner of C&L in 1989. I was fortunate to have come back to Hong Kong in the 1980s, because I experienced a golden era in Hong Kong when the economy was on the up and professional practitioners were in great demand.

Prior to taking up the SFC's chairmanship, I only worked in one firm for 40 years – C&L, or as it was later known PricewaterhouseCoopers (PwC). I guess that makes me a dinosaur, but the firm gave me a lot of opportunities. I was the senior tax partner for many years, worked on both the management and the governance side of the firm, becoming the lead director of the Board of Partners. I also became a director of the global board of PwC International for four years.

Given the size of PwC, the firm was very mindful that, where possible, its partners should give something back to society. I became a member of the Council of the HKICPA in 1991 and its President in 1997, the year of the return of sovereignty. I also participated in a lot of government advisory committee work and I became a Deputy of the National People's Congress (NPC) 12 years ago.'


Are you optimistic about the future of Hong Kong?

'There has been a lot of negative news recently, both domestically and internationally, but the relationship between Mainland China and the US has always had some tensions. Equally, there are a lot of common areas where both

countries can cooperate, so in the end things should work out at the global level.

Hong Kong has done well over the years. It is very important for us to remain international, because that is Hong Kong's niche and that is what the world looks at Hong Kong to fulfil. Equally, the Mainland is going to present a lot of opportunities for us. If you look at the Greater Bay Area development plan, Hong Kong can play a pivotal role in that. Belt and Road is also another area where Hong Kong can play a part, particularly in financial services.

So there are a lot of opportunities and initiatives at the national level that Hong Kong can tap into. I see Hong Kong as a place full of opportunity, and its values and systems are well understood by the international community. The important thing is to uphold the rule of law. Hong Kong needs to continue to be an East-meets-West city, that's where the vibrancy comes from and that's why we continue to attract talent, not just locally but from the Mainland and internationally. That's what's going to continue to make Hong Kong a success.

To build a successful international financial centre, you have to develop the infrastructure, the personnel, the legal system and the reputation. We have to preserve that status. Hong Kong people are resilient and they work hard to achieve their goals, so I have every confidence in the future of Hong Kong! 

Mr Lui was interviewed by Kieran Colvert, Editor, CSj, and Mohan Datwani, Solicitor, Senior Director and Head of Technical & Research, and a Fellow of The Hong Kong Institute of Chartered Secretaries.

A bird's eye view

Company secretaries need to be proficient in a wide range of practice areas. *CSj*, the journal of The Hong Kong Institute of Chartered Secretaries, is the only journal in Hong Kong dedicated to covering these areas, keeping readers informed of the latest developments in company secretarial practice while also providing an engaging and entertaining read. Topics covered regularly in the journal include:

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Curtailing transfer pricing in Mainland China

The roles of enhanced tax administration, corporate governance and changing ethical perceptions



Richard Simmons and Shanshan Shi, Lingnan University, review the results of recent tax research to suggest how manipulative transfer pricing may be curbed in Mainland China.

According to a conservative estimate, the tax revenue lost to the government in Mainland China as a result of tax avoidance and evasion practices is over 100 billion RMB each year. The size of this 'tax gap' jeopardises the social equity of the nation's tax system and disrupts the efficiency and competitiveness of its market economy.

For companies in Mainland China, widespread means of illegally evading tax include the under-reporting or non-reporting of income and the maintenance of alternative sets of accounting records. Companies are also able to legally avoid their taxes through, for example, taking advantage of a wide range of government tax incentives offered to encourage economic development. Central and local governments have long offered a basket of tax incentive policies: enterprises located in specific geographic locations (such as Xinjiang and Tibet), or operating in certain industries (such as software), or qualifying as high-technology or new-technology enterprises, can enjoy tax rates as low as 15% for a specified number of periods. However, the complex tax rate structure provides opportunistic circumstances for enterprises to engage in aggressive tax practices to minimise the group's overall tax liabilities, both domestically and internationally.

Manipulative transfer pricing involves the use of non-arm's length prices for the transfer of goods, services and intangibles among affiliated parties within a corporate group, shifting profits from high-tax to low-tax companies or jurisdictions, and thus minimising the total tax liability for the group. As such, it inhabits a grey area

between illegal tax evasion and legal tax avoidance, and is commonly classified today as 'aggressive tax avoidance'.

Group enterprises in Mainland China are not required to consolidate tax filing under the current tax laws and regulations. Therefore enterprises with subsidiaries in different regions can dodge taxes by shifting profits from profitable subsidiaries to loss-making subsidiaries and from high-tax to low-tax enterprises. Profits can also be shifted between time periods to reduce tax. A study by Lin, Mills and Zhang (which appeared in the *Journal of American Taxation Association* in 2014) found that in 2007, private firms, anticipating major tax reforms in Mainland China, were able to shift their taxable income to a lower-tax year, saving over 8% of their total tax expenses.

Manipulative transfer pricing results in a substantial loss of tax revenue for the government, reducing trust in the nation's tax system and seriously distorting the efficiency of the economy, so it has unsurprisingly drawn increasing attention from tax authorities. The Enterprise Income

Tax Law (EIT Law), effective since 2008, stipulated a range of measures to combat aggressive tax avoidance practices. The new law authorised the country's tax bureaus to assess additional taxes plus related fines and penalties if enterprises had engaged in manipulative transfer pricing practices. Since then, transfer pricing regulations in Mainland China have evolved rapidly along with developments in the international arena. In June 2016, the State Administration of Taxation (SAT) issued a public notice requiring firms to report considerably more detail on related-party transactions, whether domestic or international in nature, accompanied by supporting documentation. This enhanced regulation represents Mainland China's response to the new international tax landscape that is shaping the practice of transfer pricing globally.

This new tax landscape is influenced predominantly by efforts against base erosion and profit shifting (BEPS) led by the Organisation for Economic Co-operation and Development (OECD). In 2015, these efforts resulted in the issuance of 15

Highlights

- tax avoidance practices are widespread in Mainland China
- enhanced regulation represents Mainland China's response to the new international tax landscape that is shaping the practice of transfer pricing globally
- strengthening Mainland China's tax administration, improving the country's corporate governance and changing ethical perceptions in the nation towards aggressive tax avoidance, can help combat the problem of manipulative transfer pricing

BEPS action plans. Today, more than 125 countries and jurisdictions, including Mainland China, have subscribed to these action plans and are collaborating to implement associated measures. The OECD's action plans 8 to 10 specifically tackle aggressive tax avoidance practices through transfer pricing, and, together with the latest updates on OECD transfer pricing guidelines issued in October 2017, form an internationally agreed consensus for valuing cross-border transactions in today's increasingly global business environment.

Against this domestic and international background, this article considers current tax developments and recent academic research in order to suggest how three important processes – strengthening Mainland China's tax administration, improving the country's corporate governance and changing ethical perceptions in the nation towards aggressive tax avoidance – can help combat the problem of manipulative transfer pricing.

Strengthening tax administration

Strengthening tax enforcement with respect to aggressive transfer pricing practices should encourage firms to conduct their tax affairs in compliance with applicable laws and regulations. A unique aspect of Mainland China's tax system is the varied interpretation and enforcement of tax laws by tax bureaus according to level of government responsible, geographical region and type of tax. This results in a lack of consistency and uniform application of the law, which partly contributes to widespread tax avoidance practices in the country. Tax revenue is shared between central and local governments. Until June 2018, Mainland China maintained

a two-tier tax administration system, consisting of the National Tax Bureau (NTB) and Local Tax Bureaus (LTBs). The scope of tax administration and collection of each bureau was separate but duplicated in certain respects. This, coupled with the fact that the majority of listed companies are government-controlled, led to more tax avoidance activities by local government-controlled firms, as shown in the study by Tang, Mo and Chan (published in *The Accounting Review* in 2017). However, in June 2018, the two-tier tax administration system was unified. This development should streamline tax administration, provide a more integrated and consistent approach to tax enforcement, and hence encourage greater tax compliance by corporations.

Notwithstanding this development, a problem remains that in some regions tax officials take a tough stance in applying the arm's length principle to cases of transfer pricing, while in other regions they take a more relaxed approach, applying the laws leniently based on political and social connections and local government interest. In a recent study (published in *Contemporary Accounting Research* in 2018), Lin, Mills and Zhang found that in Mainland China's politically controlled economy, board ties with politicians can pose a significant challenge to effective tax enforcement. The resultant inconsistency in enforcement and punishment inevitably sends the wrong signal to taxpayers and ultimately leads to more aggressive tax avoidance behaviour.

On top of this, the current tax administration is based on a variety of taxes, and as a result lacks coordination and appropriate checks and balances. Taxpayers commonly have to deal with several individual officials in a tax

bureau according to the kind of taxes concerned. This complicates firms' tax affairs and potentially encourages them to be less compliant.

Tax laws and regulations on transfer pricing should be clear, concise and practicable for taxpayers, who should not have to take into consideration the discretionary power of particular tax officials or bureaus. The knowledge and technical skills of tax officials are also critical in handling tax avoidance cases involving transfer pricing. Recent technological and economic developments have brought many challenges for tax enforcement and, as a result, tax officials in Mainland China are increasingly required to master foreign-language skills, hone their knowledge of international tax and be tech-savvy, for example by using data analytics in transfer pricing audits. However, wide disparities in the competencies of tax officials currently exist. A continued effort on the part of the tax authorities to improve officials' tax audit knowledge and skills are clearly more than ever warranted.

Improving corporate governance

Corporate governance, referring to a set of policies and procedures established by a firm's board of directors to foster the sustainable achievement of corporate goals, is likely to play a vital role in defining a company's tax reporting behaviour. Undoubtedly, a firm may achieve better short-term tax efficiency through aggressive transfer pricing practices, but in the long run it runs the risk of reputational damage (with perhaps an associated consumer backlash) if it is viewed as a socially irresponsible corporate citizen that is not paying its fair share of taxes. Additionally, such practices may prompt suspicion of other unethical behaviour, including dishonesty in the

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a firm may achieve better short-term tax efficiency through aggressive transfer pricing practices, but in the long run it runs the risk of reputational damage”



company's financial statements. Further, if the firm is audited by the tax authorities, it would have to allocate a significant amount of manpower and other resources to deal with the issue, and may eventually be subject to tax adjustments and additional fines and penalties.

Research has shown that certain aspects of good corporate governance reduce aggressive tax avoidance. A study by Lo, Wang and Firth (appearing in the *Journal of Corporate Finance* in 2010) found that firms with a higher percentage of independent non-executive directors (INEDs) on the board are less likely to engage in transfer pricing manipulations. INED regulations were introduced in Mainland China in 2001 and the current 'one-third of the board' INED requirement was officially included in company law in 2006. However, the current percentage of INEDs on boards in Mainland China is comparatively low internationally. According to the 2018 Spenser Stuart Board Index survey, this percentage is currently somewhere between 30% and 50%, compared to 85%, 61% and 57%, in the US, UK and Singapore, respectively.

Mainland China operates a dual board system, with a supervisory board exercising supervisory power over the board of directors. This, to a certain extent, duplicates the roles of INEDs on the board of directors, since members of the supervisory board and INEDs act as the company's internal supervision mechanism, providing an independent view of the company, and objectively scrutinising the performance of management and the reporting of company performance.

In Mainland China, however, dominant controlling ownerships, by the state or provincial governments in state-owned enterprises or by the owner/founder in private enterprises, commonly result in a lack of INED independence. The Chairman of the board in a Chinese company is often equivalent to the CEO of a US company, commonly directly or indirectly nominating INEDs from his/her pool of business and social connections. Because of this, INEDs usually are not disposed to disagree with the Chairman. A few years ago a concerned government prohibited many high-ranking government officials from becoming INEDs for fear of collusion and rent-seeking

behaviour. Corporates responded by appointing many university professors as INEDs: currently, more than 45% of INEDs in Mainland China's listed companies are academic professors, a phenomenon that is very distinctive from developed economies where most INEDs have prior experience in top management positions in other companies. In sum, there is clearly still a lot of scope for improving the INED system in Mainland China.

More encouragingly on the corporate governance front, Mainland China recently introduced corporate social responsibility (CSR) reporting requirements, and by 2018 a total of 851 companies listed on the Shanghai and Shenzhen stock exchanges published CSR reports on sustainable growth. Following international trends, this year Mainland China will likely adopt an environmental, social, and governance (ESG) annual reporting framework for all listed issuers (as Hong Kong did in 2016). As its name suggests, an ESG report is more comprehensive than a company's corporate governance report. Since a company's ESG performance is connected to its long-term financial health, a strong performance in

this regard should send a strong signal to the market that the company is ethically conscious and, as such, will not engage in aggressive tax conduct such as creative transfer pricing arrangements.

Enhancing the perception of transfer pricing as an ethical issue

Manipulative transfer pricing would appear to be deeply rooted in the self-interest of the enterprises and their owners at the expense of their other various stakeholders, including the general public. Public attitudes towards aggressive tax avoidance by corporates have considerably evolved in recent years in developed nations such as the US and UK, where an explosion of civic awareness and public discussion on the issue has taken place. A tide of negative public opinion has created pressure groups such as US Uncut and UK Uncut, who have been involved in demonstrations and sit-down protests in targeted corporate locations, as well as boycotts of popular brands. This public discontent has been acknowledged by governments. In the UK, for example, Members of Parliament (MPs) have been sharply critical of the tax avoidance activities of multinational companies such as Vodafone, Google and Starbucks. In the latter case, pressure from government and the public was so intensely felt by the company that it offered to pay the UK government 'a significant amount of tax in 2012 and 2013, regardless of whether the company is profitable'. This offer, an unprecedented action for a multinational enterprise, effectively represents a donation to the tax authorities as an act of penitence for admitted tax underpayment.

Greater public concern over unethical tax practices can influence board decision-making through, for example, consumer and shareholder activism.

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tax laws and regulations on transfer pricing should be clear, concise and practicable for taxpayers, who should not have to take into consideration the discretionary power of particular tax officials or bureaus
”

However, in contrast to the case in Western countries, the perception of aggressive tax practice by corporations as essentially an unacceptable ethical issue is generally very low in Mainland China. It is currently difficult to say whether the attitudes of the general public now prevalent in Western nations towards the phenomenon will also emerge in Mainland China as forces for change. Nonetheless, the attitudes of professionals who are particularly prominent in influencing aggressive tax behaviour are likely to grow more critical towards the practice.

For example, professional accountants, who act as company board members or in-house tax advisors, have long been expected to serve the public interest. Indeed, the *International Code of Ethics for Professional Accountants* of the International Ethics Standards Board for Accountants (IESBA) states at its very beginning, 'A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest'. The Code of Ethics of the Chinese Institute of CPAs (CICPA) is converging with IESBA's code, and the CICPA is now dedicated to instilling commitment to the values expressed in its Code amongst its members. This should hopefully impact on the attitudes

of professional accountants in Mainland China towards manipulative transfer pricing. In a study published in the *Accounting Auditing and Accountability Journal* in 2016, Shafer, Simmons and Yip found that tax accountants in Mainland China who possessed higher levels of professional commitment judged manipulative transfer pricing to be more unethical and expressed a lower intention of engaging in this activity.

Enhanced commitment to professional ideals amongst individuals in firms that commonly advise corporations on their tax affairs is likely to lead to a more ethical culture within those firms, especially if those individuals are in a position to 'lead from the top'. This culture shift can hopefully reduce the promotion of aggressive tax schemes by all within the firm. In a study published in the *Accounting Auditing and Accountability Journal* in 2011, Shafer and Simmons found that the existence of a strong ethical culture within accounting firms in Mainland China significantly reduced the reported likelihood of individual tax practitioners within those firms supporting manipulative transfer pricing arrangements with their clients.

Finally, the attitudes of budding tax professionals in Mainland China

towards aggressive tax avoidance can be enhanced through education and training. One means to this end is through more emphasis on ethics in tax courses offered at universities. A study by Simmons, published in the *Journal of Business Ethics Education* in 2014, found that undergraduate students at a Hong Kong university became more critical of manipulative transfer pricing after taking a taxation course imbued with a significant ethical component. Another means is through greater effort by professional bodies in Mainland China such as the CICPA to instill ethics more pervasively into the tax component, currently predominantly technical, of

their professional qualifying programmes. Revisions to training programmes that stress the fundamental importance of ethics to tax advice, and building it into the heart of tax decision-making frameworks, will go a long way towards the advancement of a new generation of more ethically minded tax specialists in Mainland China.

Conclusions

Improvements in the effectiveness of Mainland China's tax administration, enhancement of the corporate governance of firms with regard to taxation and a deeper and more widespread perception amongst corporate

board members, professionals and the general public of aggressive tax avoidance as an ethical issue can together help create an environment which is increasingly unfriendly to manipulative transfer pricing. If these developments continue to unfold, they can help transform corporate behaviour and reduce the harm manipulative transfer pricing can inflict on government revenues, trust in Mainland China's tax system and the country's economy in general.

Richard Simmons, Professor of Teaching, and Shanshan Shi, Postgraduate Diploma Programmes Director
Lingnan University

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Competition update: Q&A with Brent Snyder



On the third anniversary of the Hong Kong Competition Ordinance, Brent Snyder, Chief Executive Officer of the Competition Commission, answers some frequently asked questions about the policies and enforcement actions of the Competition Commission.

The Competition Commission (the Commission) is investigating the Hong Kong Seaport Alliance – does that also mean it can investigate Cathay Pacific's acquisition of Hong Kong Express under the Competition Ordinance?

'The merger rule of the Competition Ordinance (the Ordinance) is limited only to mergers in the telecommunications (telecom) sector. As such, neither the Commission nor the Communications Authority is able to review any mergers outside the telecom sector. The Commission is able to investigate the Hong Kong Seaport Alliance because it is not a merger of the parties. Instead, it is a joint venture agreement between competitors that can be reviewed under the First Conduct Rule.

By contrast, it has been reported that Cathay Pacific is acquiring 100% of the shares of Hong Kong Express.

If so, this constitutes a merger and places the transaction beyond the scope of the Ordinance. That said, the Commission is actively engaging with the government to encourage a competition assessment of the acquisition to the extent permissible within the relevant regulatory ambit and also to offer the Commission's services in that regard.'

Does Hong Kong need a merger rule that applies to more than just the telecom sector?

'From the perspective of a competition agency, a cross-sector merger rule is an integral part of a competition law regime. So my answer is yes. For Hong Kong, it is really a matter of when.

It is not uncommon for a jurisdiction to adopt a competition law that does not initially include a merger provision. A number of jurisdictions have added

Highlights

- the Commission has prioritised cartel enforcement from the outset of its work, but is also going after non-cartel conduct that harms competition in Hong Kong
- the Commission conducts its investigations without regard to the size or importance of the accused parties, the focus should rather be on the harm to the victimised consumers
- the Commission is not focused on particular market sectors to the exclusion of others – it will pursue conduct that raises competitive concerns in whatever sector it is found



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I expect that Hong Kong will make the same decision as other jurisdictions and add a general merger rule to the Competition Ordinance at some point in the future
 ”

merger provisions later, after the need for one became apparent or the competition enforcement agency had gained sufficient experience enforcing conduct rules. Because merger investigations are often the most complicated and time- and resource-intensive investigations that a competition agency undertakes, this is not necessarily an unreasonable approach.

I expect that Hong Kong will make the same decision as other jurisdictions and add a general merger rule to the Competition Ordinance at some point in the future. In making that decision, it will have to balance the Commission's experience and resource readiness for that additional mandate against the risk that, in the interim, potentially anticompetitive transactions will proceed without scrutiny under the Ordinance. Unscrutinised transactions have the potential to dramatically reduce competition and harm consumers.

On the experience side, I am happy to report that the Commission is quickly moving up the learning curve, gaining significant experience and taking on more complicated investigations!

What is the Commission's position on the proposed Franchised Taxi Scheme and legalising ride-hailing services?

'The Commission provided advice on the government's proposed Franchised Taxi Scheme and we have made that advice publicly available on our website (www.compcomm.hk) so I will not detail it here. Suffice it to say, the Commission believes that the proposed scheme raises a number of competition concerns and, more fundamentally, is inadequate to bring about the type of changes to the existing taxi industry that Hong Kong consumers strongly support.

The Commission also advocates for the government to provide opportunities for ride-hailing services to operate legally in Hong Kong, subject to appropriate

regulations necessary to protect health and safety.

In this regard, I note recent newspaper reports that a number of taxi franchises are developing taxi-hailing apps to better serve customers. The Commission welcomes this innovation, which appears to respond to competitive pressure from ride-hailing services that are not even legal in Hong Kong. This demonstrates the types of benefits to consumers that could flow from more legalised competition in this sector!

Why have your second and third enforcement actions focused on small building decorating contractors rather than big tigers?

'All of our enforcement actions to date have focused on hardcore cartels because they are the worst competitive abuses. That is the case whether the cartelists are big companies or small ones. Indeed, cartels can result in even small competitors banding together to eliminate competition between them and, in that way, collectively turning themselves into a big tiger. That is why cartels are so harmful.

It is also important to recognise that the focus should be on the harm to the victimised consumers rather than the size of the cartel. In our second and third enforcement actions, the consumers were among the most vulnerable of Hong Kong's citizens – residents of its public housing estates.

The bottom line is that any tiger that is big enough to participate in a cartel that hurts Hong Kong's consumers is big enough for the Commission to hunt. I'm pretty sure that nobody who is being killed by a tiger says as their last words,

"It could be worse – it could be a big tiger eating me!"

Is the Commission doing anything about big tigers in Hong Kong?

The Commission has engaged with large business interests and important market sectors in a number of ways. The Commission's first enforcement action was against a US software company and some sizeable distributors in Hong Kong, including a subsidiary of a well-known telecom company.

The Commission's first block exemption order involved Hong Kong's liner shipping association and its first application for

decision involved many of its leading financial institutions. In both cases, the Commission conducted its analysis without regard to the size or importance of the applicants, and it issued decisions that did not exempt the liner shippers' voluntary discussion agreements or the financial institutions' Code of Banking Practice from the First Conduct Rule as requested.

The Commission is now considering an application from Hong Kong's Association of Pharmaceutical Industries. It involves major players in that sector. The Commission has active Second Conduct Rule investigations involving some very major businesses operating in Hong Kong, and, as previously

announced, it is investigating the Hong Kong Seaport Alliance, which involves its major port operators.

These are just a few examples of the work we are doing that directly involves very significant issues impacting major Hong Kong businesses and market sectors and, thus, consumers.'

Is the Commission going to take enforcement action against non-cartel conduct that harms competition in Hong Kong?

'In appropriate cases – absolutely. The Commission has a broad and very diverse range of ongoing investigations, some



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 any tiger that is big
 enough to participate
 in a cartel that hurts
 Hong Kong’s consumers
 is big enough for the
 Commission to hunt
 ”



of which I am confident will lead to enforcement outcomes. We currently have investigations under the Second Conduct Rule, as well as investigations of non-SAC (serious anti-competitive) conduct under the First Conduct Rule that involve both horizontal and vertical agreements. Some of those investigations may present "object" contraventions and others may present "effects" contraventions.

Our portfolio of non-SAC investigations has increased to the point that we have reorganised our Operations Division into two teams, one of which primarily focuses on SAC cartel investigations and the other of which focuses on investigations under the Second Conduct Rule and First Conduct Rule investigations involving an assessment of competitive effects. Both teams have plenty to keep them busy for the foreseeable future, and we keep adding new things!

I want to take this opportunity to emphasise a point about Second Conduct Rule investigations. In my experience, it is very rare for an abuse of substantial market power investigation to start as a result of a consumer complaint. Consumers rarely are in a position to have

knowledge of the types of conduct, such as refusals to deal or exclusive distribution arrangements, which can constitute abuse by a dominant undertaking.

Rather, it is complaints by the businesses that are the victims of those strong-armed exclusionary tactics that lead to investigations. For the Commission to maximise its Second Conduct Rule enforcement, we need businesses who are being excluded or who have knowledge of the conduct to make the Commission aware of it and provide us with information so that we have a basis to begin to investigate.

It is not enough for businesses to complain in the media about perceived abuses by dominant players and then decline to provide information when the Commission follows up. This is something that we expect to make a point of future emphasis in our public advocacy work!

Will the Commission consider accepting commitments as a remedy for serious anticompetitive cartel conduct?

'While the ultimate decision on what remedies to accept in a case is for our Commission members to make,

I anticipate that it will rarely be the case that Commission executives will recommend accepting commitments in the case of cartel conduct.

First, cartels are the very worst competitive abuses and, thus, most deserving of pecuniary penalties. It is important to seek those penalties in order to send an appropriate deterrent message. This is why the Commission has prioritised cartel enforcement from the outset of its work.

Second, accepting a commitment in a cartel case creates a risk of undermining our leniency program. If a company thinks it can resolve an investigation with a commitment if the cartel is detected, it may decide not to come forward to self-report the cartel and seek leniency.

For those reasons, I do not expect to often recommend accepting commitments in cartel cases.'

Will the Commission be using its other enforcement remedies, such as infringement notices and warning notices?

'The use of an infringement notice in a cartel case raises some of the same

issues as using a commitment because an infringement notice involves the Commission offering a commitment to the cartel participant after a full investigation. For that reason, I expect that Commission executives making a recommendation to resolve an investigation involving SAC with an infringement notice likely will be very much the exception rather than the rule.

Infringement notices may be an appropriate remedy for resolving Second Conduct Rule cases in some circumstances. Whether we would be willing to accept one will depend on the facts of a given case. The egregiousness

Recap of Cap 619

Hong Kong's Competition Ordinance (Cap 619) prohibits restrictions on competition in Hong Kong through three competition rules:

- The First Conduct Rule prohibits anti-competitive agreements and concerted practices
- The Second Conduct Rule prohibits abuse of market power, and
- The Merger Rule prohibits anti-competitive mergers and acquisitions.

The First Conduct Rule and the Second Conduct Rule apply to all sectors of the Hong Kong economy. At present, the Merger Rule only applies to mergers involving carrier licence holders within the meaning of the Telecommunications Ordinance (Cap 106).

and intent of the conduct would be among the factors we would take into account.

The Commission has every intention of issuing warning notices in appropriate cases involving non-SAC conduct under the First Conduct Rule. We currently have investigations where a warning notice will be issued if we conclude that there is a reasonable cause to believe there has been a contravention of the First Conduct Rule.

This raises an important point. Warning notices do not present the Commission with an opportunity to cut corners or conduct less rigorous investigations. We are required to conduct an investigation with the same rigour as one in which we can seek pecuniary penalties because the same standard applies to both – reasonable cause to believe a contravention has occurred. The same applies to infringement notices.

This fact, coupled with the fact that warning notices are likely the only initial remedy available in First Conduct Rule cases requiring an analysis of competitive effects, means that we will only be able to issue warning notices after investigations that probably will be among our longest and most complicated. Those investigations require special care to ensure that our analysis is correct because, otherwise, even a warning notice has the potential to chill legitimate competitive conduct if erroneously issued.

For those reasons, warning notices will not be issued without full investigation and, as a result, may not be issued

as frequently as some might expect. Nonetheless, we fully expect to use them.

Finally, it is worth mentioning that the Commission has issued written compliance reminders on several occasions to very small businesses engaged in certain types of conduct, such as very short-lived cartels, that would permit a pecuniary penalty action or infringement notice. The Commission issued compliance reminders after completing investigations that warranted a response but, in the exercise of its discretion, one that was more restrained than the use of its formal remedies.'

Is the Commission focused on any particular market sectors?

'The Commission has ongoing projects focused on particular market sectors. These projects, at present, are non-public and are directed at understanding whether and what competitive restraints may exist in those sectors. They may or may not eventually lead to formal investigations or result in formal studies with conclusions and recommendations. It should be noted that where a study uncovers information or evidence of a suspected contravention, we may decide to delay publication of the study as necessary to protect the integrity of any resulting investigative work.

Finally, we are not focused on particular market sectors to the exclusion of others. We will pursue conduct that raises competitive concerns in whatever sector we find it.'

This article has been adapted from the keynote speech given by Brent Snyder at a British Chamber of Commerce and Freshfields Breakfast Briefing in April 2019.

Putting the G back into ESG



Hong Kong Exchanges and Clearing Ltd proposes new regulatory requirements designed to boost the effectiveness of companies' governance structures for the management of environmental, social and governance (ESG) issues.

Tougher regulation of ESG management and the disclosure of ESG performance and risks has been a notable trend in recent years, both globally and in Hong Kong. Hong Kong Exchanges and Clearing Ltd (HKEX) introduced its *Environmental, Social and Governance Reporting Guide* (ESG Guide) in 2013, and has subsequently expanded its scope and compliance obligations – for example upgrading the guide's General Disclosures and Environmental key performance indicators (KPIs) to 'comply or explain' in 2016.

In its first phase, the regulatory focus in Hong Kong was on assisting companies to establish the internal controls necessary to ensure that ESG issues are effectively monitored, managed and disclosed. More recently, the emphasis has shifted to assisting companies to move up to the next level where the management of ESG is not primarily a compliance or PR exercise but a fundamental part of corporate strategy.

The most recent HKEX review of listed companies' compliance with the ESG Guide (*Analysis of Environment, Social and Governance Practice Disclosure in 2016/2017*, published in May 2018) found that, superficially, Hong Kong companies have an excellent compliance record when it comes to ESG disclosure. All sampled issuers duly published their ESG reports within three months of their annual report, as required by the ESG Guide. Digging deeper, however, the HKEX review found areas of weakness in listed companies' approach

to ESG management and disclosure. In particular, the review lamented the lack of discussion and details regarding issuers' ESG governance structures and the board's involvement in the ESG reporting process and the process of materiality assessments.

Last month (May 2019), HKEX published its *Consultation Paper on Review of the ESG Reporting Guide and Related Listing Rules* (ESG Consultation) proposing revisions to the ESG Guide designed, among other things, to address these areas of weakness.

Oversight of ESG is the board's responsibility

The ESG Consultation emphasises the crucial importance for issuers to have in place a governance structure for ESG. 'It is important for ESG matters to be led by the board so as to ensure, amongst others, that ESG issues are factored into high-level discussions, and appropriate systems and

processes are implemented with adequate resources. To facilitate the inclusion of these essential elements in the ESG reports, we propose to introduce mandatory reporting requirements requiring the disclosure of the board's involvement in ESG governance,' the consultation states.

Under the new proposals, issuers would be required to include a statement from the board in their ESG reports setting out the board's consideration of ESG issues. This would need to include the disclosure of:

- i. the board's oversight of ESG issues
- ii. the process used to identify, evaluate and manage material ESG-related issues (including risks to the issuer's businesses), and
- iii. how the board reviews progress made against ESG-related goals and targets.

Highlights

Proposed revisions to the *Environmental, Social and Governance Reporting Guide* include:

- a requirement for issuers to include a statement from the board in their ESG reports setting out the board's oversight of ESG issues and how the board reviews progress made against ESG-related goals and targets
- a requirement to disclose the process for the selection of material ESG factors, and
- a requirement to disclosure relevant targets regarding issues such as emissions, energy use, water efficiency and waste reduction, as well as the steps taken to achieve them.

Materiality

The ESG Consultation also seeks to highlight the fact that materiality in respect of ESG is key to meaningful and concise reporting. 'The key to a meaningful and concise ESG report is materiality,' the ESG Consultation states.

'Materiality is the threshold at which ESG issues determined by the board are sufficiently important to investors and other stakeholders that they should be reported. It is important that the issuer explains its materiality assessment process in the ESG report.'

The ESG Consultation proposes to introduce a mandatory requirement for companies' ESG reports to contain an explanation of the application of the reporting principles and reporting boundary relevant to the company. Under the HKEX ESG Guide, materiality is a reporting principle which underpins the preparation of ESG reports. Under the proposals, issuers would be required to disclose the process for the selection of material ESG factors, including a description of the process and results of the issuer's stakeholder engagement, if any, as well as the process used to identify the specific entities or operations that are included in the ESG report.

Guidance materials

In addition to the ESG Consultation reviewed in this article, Hong Kong Exchanges and Clearing Ltd (HKEX) has launched an e-training course, 'ESG Governance and Reporting', published new frequently asked questions on its website and revised 'Guidance Letter HKEX-GL86-16' to require additional disclosure relating to issuers' policies on board diversity.

The new e-training course

The new 'ESG Governance and Reporting' e-training course explains the board's leadership role in ESG matters and covers the following six topics:

1. what is ESG, and why is it important?
2. board's role in ESG governance
3. why report on ESG?
4. essential elements in an ESG report
5. details on ESG reporting, and
6. ESG disclosure by IPO applicants

The e-training takes approximately 45 minutes to complete.

Frequently asked questions

The new FAQs (No 24K and 24L in Series 17 and FAQ No 2A in Series 18) have been added to the HKEX website to clarify how different aspects of ESG relate to the Corporate Governance Code.

Gender diversity

In respect of disclosure in listing documents by new applicants, HKEX has revised 'Guidance Letter HKEX-GL86-16' to require additional disclosure relating to issuers' policies on board diversity (including gender) and how gender diversity of the board can be achieved in the case of a single gender board. The revised Guidance Letter also sets out expected disclosures on ESG matters, including material information on applicants' environmental policies, and details of the process used to identify, evaluate and manage significant ESG risks.

The guidance materials are available online: www.hkex.com.hk

Target setting

The annual research reports by Alaya Consulting (see endnote for details) highlight the benefits of target setting for effective ESG governance. Tony Wong, Founder, and Regina Tai, Consultant, Alaya Consulting, stated in the October 2018 edition of CSj that 'establishing targets in the long-run helps to set out strategies and a roadmap towards sustainable growth'.

The 2018 Alaya research found that less than 20% of the companies surveyed set environmental and social targets. The Alaya report suggests that 'companies are yet to realise the advantage of setting SMART (specific, measurable, attainable, relevant and time bound) and effective targets as a driving force in ESG, and integrating these into the company's business strategy'.

HKEX is similarly keen to promote the benefits of companies setting relevant targets. The ESG Consultation proposes to amend the ESG Guide environmental KPIs to require disclosure of relevant targets

“ it is important for ESG matters to be led by the board ”

regarding issues such as emissions, energy use, water efficiency and waste reduction, as well as the steps taken to achieve them.

'We believe that having specific targets and requiring disclosure of the steps taken to achieve them would drive issuers to scrutinise and refine their strategies and systems, which ultimately may lead to better risk management and improved performance' the ESG Consultation states. It adds that disclosure requirements regarding targets would also help to align Hong Kong with international standards such as the Global Reporting Initiative (GRI) standards and the recommendations published by the Task Force on Climate-related Financial Disclosures (TCFD) in June 2017.

Other HKEX proposals

The ESG Consultation makes a number of other proposals designed to improve the management of ESG issues by listed issuers in Hong Kong and to better align Hong Kong with international standards.

Climate change

For example, the risks associated with climate change have been an increasing global concern and focus, with investors demanding more information on how climate change has impacted or may impact a company. Moreover, the TCFD recommendations mentioned above call

for disclosure on the actual and potential impacts of climate-related risks and opportunities on the company.

'Climate change poses serious risks to the global economy and has an impact across many, if not all sectors, in which our issuers operate. These risks could have significant impact on the issuers' long term sustainability,' the ESG Consultation states.

HKEX points out that these considerations should be included in issuers' ESG reports. The ESG Consultation therefore proposes to introduce a new Aspect (subject to 'comply or explain') requiring disclosure of the significant climate-related issues which have impacted, and those which may impact, the issuer and the actions taken to manage them.

Upgrading Social KPIs to comply or explain

The ESG Consultation also proposes to upgrade the disclosure obligation of the Social KPIs of the ESG Guide, which are currently recommended (voluntary) disclosures, to comply or explain.


The level of disclosure for Social KPIs has been relatively low. HKEX is concerned that this may give the wrong impression that they are less important than Environmental KPIs, resulting in less attention being paid by the issuers.

'Social KPIs are no less important than Environmental KPIs and for some issuers, they are more material. It is important to note that if any of the Social KPIs are considered immaterial to an issuer's businesses, the issuer has the flexibility to explain rather than make irrelevant disclosures,' the ESG Consultation states.

Shortening the deadline for publication of ESG reports

The ESG Consultation also proposes to shorten the deadline for publication of ESG reports. Currently issuers are required to publish their reports within three months from the publication of their annual report. Since annual reports have to be published within four months of the relevant year-end, this means that the ESG report may be published seven months after the year end.

'It is considered best practice to provide ESG data at the same time as the annual report and when accounts are published, or as soon as possible afterwards in order to present to investors a more comprehensive picture and up-to-date information on the company's performance and long-term prospects,' the ESG Consultation states.

HKEX proposes to shorten the time required to publish an ESG report to align with the publication timeframe of the annual report. Issuers would be required to publish their reports within four months for Main Board issuers and within three months for GEM issuers from the financial year-end. 

The ESG Consultation discussed in this article is available online: www.hkex.com.hk. The Alaya Consulting research reports on the ESG disclosure practices of Hong Kong listed companies are available online: www.alayaconsulting.com.hk.

Analyses of the Alaya reports, which appeared in November 2017 and October 2018 editions of CSj, are available online at: <http://csj.hkics.org.hk>.

Anti-corruption compliance

The Independent Commission Against Corruption (ICAC) offers guidance on how to comply with Hong Kong's upgraded disclosure requirements relating to anti-corruption policies and performance.

Globally, there is an increasing demand for better disclosure by listed companies, and stakeholders nowadays focus not only on listed companies' financial performance but also on their performance in environmental, social and governance (ESG) aspects, including anti-corruption. In the international arena, some jurisdictions (such as Mainland China and Singapore) regulate the disclosure of ESG information through the listing rules of their local stock exchanges, while other jurisdictions (such as the UK and France) have introduced statutory amendments to codify disclosure requirements relating to non-financial information. In nearly all jurisdictions where disclosure of ESG information is required, anti-corruption is one of the essential disclosure aspects.

Anti-corruption measures form a vital part of corporate governance and are thus crucial to a company's success. These measures include the means by which companies manage corruption risks and tackle corruption-related issues. Apart from the conventional financial and corporate governance reporting, quality disclosure of anti-corruption information and transparency of a company's anti-corruption policies not only enhances a company's goodwill and value, but also helps stakeholders, in particular investors, to understand the companies' commitment, abilities and performance in anti-corruption initiatives and to make informed investment decisions.

In 2016, Hong Kong reached an important milestone in the enhancement



of the transparency of listed companies' ESG aspects when Hong Kong Exchanges and Clearing Ltd (HKEX) upgraded its required and recommended ESG reporting standards. Listed companies need to disclose, among other things, information on their anti-corruption policies and compliance with relevant laws and regulations on a comply-or-explain basis. This means that a listed company must report on such provisions or provide considered reasons for non-disclosure. In addition, HKEX recommends that listed companies disclose details of concluded legal cases regarding corrupt practices brought against them or their employees, and a description of their preventive measures and whistleblowing procedures.

Anti-corruption guidelines

Compliance with the HKEX upgraded ESG reporting requirements necessitates the implementation of a robust anti-corruption system. To assist listed companies in establishing and reviewing their anti-corruption systems, the

Highlights

- some companies appear to be disclosing only the minimum anti-corruption information required by Hong Kong Exchanges and Clearing Ltd
- upgrading the transparency of their anti-corruption policies and performance will boost listed companies goodwill and value
- listed companies should be disclosing their assessment of the risks and impacts of corruption on the key operations of the company



Corruption Prevention Advisory Service (CPAS) of the Corruption Prevention Department, ICAC, published its *Anti-corruption Programme – A Guide for Listed Companies* (the Guide) in late 2016. The Guide provides comprehensive guidance on the components of a robust anti-corruption programme.

The Guide also recommends best practices in anti-corruption governance with reference to international standards. These include practices recommended by the G20 Anti-Corruption Working Group, the Global Compact Working Group, Global Reporting Initiative, Transparency International and the World Bank. The recommended practices of the Guide generally align with the requirements of ISO 37001 (*Anti-bribery Management Systems – Requirements with Guidance for Use*) published in 2016, which specifies the requirements and provides guidance for establishing, implementing, maintaining, reviewing and improving an anti-bribery management system. The recommended practices relate to the following areas:

- ***anti-corruption laws and regulations*** – major anti-corruption laws and regulations relevant to business entities, including the Prevention of Bribery Ordinance (Cap 201) and overseas anti-corruption legislation, as well as regulations relating to the prevention of corruption in listed companies
- ***roles and responsibilities*** – the governance framework adopted to implement an anti-corruption programme and the suggested roles and responsibilities of different personnel and parties in the programme
- ***anti-corruption policies*** – top-level commitment to ethical business practices and anti-corruption, key integrity and conduct requirements for company's personnel and business partners, the company's whistleblowing policy and a brief description of corporate anti-corruption programme, and
- ***anti-corruption programme*** – key elements of companies' codes of conduct and recommended practices for corruption risk assessment, anti-corruption controls and integrity training.

Hong Kong's current scorecard

In 2018, to assess listed companies' performance in implementing the upgraded reporting requirements in anti-corruption, CPAS reviewed a number of ESG reports and/or annual reports for the financial year commencing in 2016. The samples covered companies listed on both the Main Board and GEM Board, in different industries and with different market capitalisation, reflecting the landscape of anti-corruption compliance among listed companies in Hong Kong. The major observations of the review were generally in line with those identified in the HKEX Analysis of ESG Practice Disclosure in 2016/2017. The following is a summary, which is by no means exhaustive, of the major findings of the review.

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**anti-corruption
 measures form a vital
 part of corporate
 governance and are
 thus crucial to a
 company’s success**
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Compliance with the reporting requirements

Although the vast majority of sampled companies disclosed information on their anti-corruption policies and compliance (as required by the HKEX comply-or-explain provisions), a number of companies did not give considered reasons for non-disclosure, which amounted to a breach of the listing rules. The review also noted that, on average, only around 75% of sampled companies disclosed information relating to the HKEX 'recommended disclosures'.

Disclosure of recommended core elements

There was a substantial gap between listed companies' disclosures and CPAS's recommended core disclosure elements (see below). For instance, only around 40% of sampled listed companies disclosed information about their policies on the acceptance of advantages and entertainment, and managing conflicts of interest. As for disclosure on corporate websites, only a small proportion of listed companies made the integrity requirements for directors, staff and business partners, as well as their whistleblowing policy, available on their corporate websites for reference by stakeholders.

Quality of disclosure

Where listed companies complied with HKEX's reporting requirements, the quality of disclosures varied. While some listed companies made very good disclosure by providing comprehensive descriptions of their anti-corruption policies and compliance information, some companies appeared to have adopted a box-ticking approach and sought only to disclose minimum information required by HKEX. For instance, some listed companies either gave vague descriptions of their anti-corruption policies and compliance information, or merely provided generic statements, such as 'we have an anti-corruption policy', or 'we have complied with all relevant laws and regulations' without further elaboration. Such statements are neither informative nor helpful to stakeholders. As far as the anti-corruption policy is concerned, while it may be impractical to set out the policy in full, listed companies are expected to provide a summary of the policy and/or embed links to the related codes of conduct, guidelines and integrity requirements so as to provide useful information for stakeholders.

Recommended core disclosure elements

The ICAC understands that a checkbox approach may not be appropriate or effective for listed companies deciding on the anti-corruption information to be disclosed, but it will be useful to bear in mind the core elements needed by stakeholders in their assessment of companies' risk controls. As there is no one-size-fits-all approach in ESG reporting, listed companies (and the parties which help them prepare the ESG reports) should assess the materiality of individual elements

and their impact on the companies' operations when deciding on the anti-corruption information to be disclosed.

In light of the upgraded reporting standards and having taken into account international practices in anti-corruption disclosure, CPAS recommends five core elements of a corporate anti-corruption programme that listed companies should disclose in their ESG reports.

1. ***Anti-corruption policies.*** Companies should disclose their anti-corruption policies, including management's zero-tolerance against corruption in Hong Kong and elsewhere, and commitment to ethical practices/standards.
2. ***Corruption risk assessment.*** Companies should disclose their assessment of the risks and impacts of corruption on the key operations of the company, including their materiality assessment of anti-corruption issues.
3. ***Compliance with laws and regulations.*** Companies should disclose information on compliance with laws and regulations having a significant impact on the company (including local and overseas legislations related to corruption), and the number of concluded legal cases regarding corrupt practices brought against the company or its staff, and their outcomes.
4. ***Management approach and measures.*** Companies should disclose the anti-corruption measures adopted, and their execution and monitoring, including: (i) integrity requirements for directors

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 compliance with the HKEX
 upgraded ESG reporting
 requirements necessitates the
 implementation of a robust
 anti-corruption system
 ”



and staff, covering the policy on offering and acceptance of advantages and entertainment, and managing conflicts of interest; (ii) whistleblowing policy, procedures and channels for reporting corruption or irregularities; (iii) integrity requirements for business partners and associates; (iv) corruption prevention controls for high-risk areas or procedures; and (v) clear and measurable target key performance indicators for the forthcoming years to facilitate continuous monitoring.

5. **Capacity building.** Companies should disclose their efforts in anti-corruption training to promote ethical

business practices and awareness of directors, staff and business partners on corruption prevention, and statistics on anti-corruption training (for example the number of participants and training hours).

Apart from disclosing the above information in ESG reports, CPAS also recommends listed companies upload important anti-corruption policy documents to their corporate websites, including their codes of conduct for directors and staff, their integrity requirements for business partners (for example suppliers and contractors) and their whistleblowing policies and procedures, so that business

counterparts and the investing public may obtain readily available information on the companies.

Corruption Prevention Advisory Service, Corruption Prevention Department

Independent Commission Against Corruption

The CPAS 'Anti-corruption Programme – A Guide for Listed Companies' is available for view and download at the CPAS website (cpas.icac.hk), or via the ESG Resources Hyperlinks on the HKEX website (www.hkex.com.hk).

At your service

The ICAC's Corruption Prevention Advisory Service (CPAS) provides corruption prevention advice and services to private companies, organisations and individuals. The CPAS website (cpas.icac.hk) offers access to corruption prevention resources, such as corruption prevention guides and toolkits, case studies, quick tips and red flags. Individuals and organisations can also subscribe to CPAS's email alert service by scanning the QR code below to receive regular news and updates on corruption prevention (including newsletters and training packages).

CPAS can be contacted by email: cpas@cpd.icac.org.hk, or via its hotline: 2526 6363. The hotline is available Monday to Friday, 9am to 6pm, with a voice message after office hours.





Cyber risk

What a board should be asking

Cyber risk is now a major area of concern for all organisations and the board should be knowledgeable about such risk. Richard Sheath, Director, Independent Audit Ltd, looks at how a board can exercise oversight of this fast-moving and difficult-to-understand critical threat.

Most directors worry about their organisation's exposure to cyber risk, especially when they sense it's not a matter of 'if' but 'when'. But few of them feel confident that their technical knowledge is sufficient to test what they are being told. Are they merely forming a half-baked judgement on the adequacy of their mitigation approach or the organisation's ability to respond to a major breach? This is one of those areas where directors can't be expected to become experts and finding someone who's already expert but has the right profile to become a non-executive director (NED), will always be tricky – especially

with such a limited pool to dip into. In fact, increasing numbers of boards have stopped looking for cyber-NEDs and instead are appointing retained experts as their advisers. But of course even those need to be used wisely by a board.

So, what's to be done? At a minimum, the board needs to have a clear framework of questions to ask – one based on a good understanding of the full breadth of the risk and required response. This article gives an introduction to this complex topic and provides a few pointers on good practice to help directors cover the ground and avoid the pitfalls.

Highlights

- directors should not be too accepting of the assurances they are given
- cyber risks are new and constantly changing so doubling up on assurance over the company's defences may well be needed
- directors should tie cyber risk considerations into strategic discussions and growth plans

| Good practices to consider | Things to avoid |
|---|---|
| <p>Get a fully-scoped picture of both the types of risks and where they might hit. Most boards are familiar with virus and hacking risks – but what about risks such as extortion, theft, information loss and espionage? Many have focused on the data loss but have a less than complete picture of the possible weaknesses in the operating structures, including the knock-on effects across operations, products and services.</p> | <p>Avoid just accepting the scope presented by IT. The IT team might not have the understanding of operational structures and processes that is needed to set out the risks in full – or of the potential hit on service delivery and customers. NEDs need to hear from across the executive team, with each part of the organisation setting out their own scope of risk. Once that's laid out, the NEDs need to stand back and use their experience and common sense to ask whether it really is a full picture of the significant risks.</p> |
| <p>Develop a framework for the board to use in considering the possible costs and consequences. That means getting a picture of each area of impact – with the most significant, on a risk-based assessment, reaching the board for discussion. This needs to be wide-ranging, thinking through the consequences across the risk profile and risk register.</p> | <p>Avoid thinking narrowly in terms of the cash-cost hit of an interruption to operations. The consequences can impact the share price, reputation and fundraising capabilities, and can create legal liabilities, health and safety incidents, failure to deliver contracts, regulatory fines – the list goes on. A board should be taking a look across its risk universe and asking how different types of hit might affect the risk assessment, and what that implies for the required mitigation approach and related investment.</p> |
| <p>Understand the exposures arising from third parties. The organisation itself might be on top of things, but where are the weak points in the defences that come from suppliers and outsourcers – and any others who have an interface with your systems? Get a good understanding of the positioning of the organisation around 'open' or 'closed' approaches to allowing data to be accessed by third parties.</p> | <p>Avoid focusing on the internally owned risks and risk management. The board needs to be seeing a map of exposures and understanding how management are managing the risks. Assurance over those controls matters too – can the board be sure that the mitigation is working well in practice, not just on paper?</p> |
| <p>Get a picture of how mitigation resources are being deployed versus the relative risks and potential consequences and costs. Then revisit the assessment as the risk environment changes.</p> | <p>Avoid assuming that management are making the right calls on levels of investment and the targeting of resources. As always, NEDs should not be looking to second-guess management. But they should be able to understand how management determines the appropriateness of investment levels versus risks, the checks and balances built into the decision-making, and how they keep on top of it all as the risks and the operations change.</p> |
| <p>Tie cyber risk considerations into strategic discussions and growth plans. New products, services, platforms, outsourcing, delivery mechanisms, partners, JVs, acquisitions, channels and geographies all have a cyber risk angle, especially if systems development or integration is involved.</p> | <p>Avoid neglecting to think through the cyber risk implications of strategic decisions. It is natural for boards to look at the financial risk/reward balance – but are the cyber risks manageable and acceptable, especially when set against the projected returns?</p> |
| <p>Watch the geographical factor. New jurisdictions may change the game in terms of regulation, liability and control requirements – as well creating potential exposures in countries with different standards or cultures around security or hacking.</p> | <p>Avoid thinking that, because all looks good at head office, you are on top of things. It's fully appreciated that different operating environments and cultures have to be factored into business-as-usual controls and assurance approaches – but have they kept up with the cyber threat?</p> |

| Good practices to consider | Things to avoid |
|--|---|
| <p>Understand the response plans for when a breach happens and how they have been tested. That means understanding both the day-to-day responses as multiple attacks happen (nowadays part of business as usual) and how the organisation will respond to a major breach of the defences. To do this, it helps to have a clear framework for the board to think within, covering the main categories (for example communication, customers, executive responsibilities and business continuity).</p> | <p>Avoid just accepting assurances that 'we have a plan'. The board should be rigorously challenging its logic and looking for evidence of testing. Independent assurance will need to come into play – and if that means internal audit, do they really have the expertise? As well as covering the operational practicalities, is the external communication strategy clear? How will we look after our customers and stakeholders who are affected? A board needs to help management look above the internal challenges to make sure those outside are looked after.</p> |
| <p>Ask the 'what if' question. Boards who have tried wargaming a major breach typically find this helpful. Taking a close, up-to-date look at business continuity planning and testing is an obvious need too.</p> | <p>Avoid being too accepting of assurances that 'it'll be alright on the night'. Boards can be just too accepting of the assurance they are given. It's not a question of distrusting what they are being told – it's just that these are not conventional risks and controls. It's new and it's constantly changing, so doubling up on the assurance over the defences may well be needed.</p> |
| <p>Get a clear picture of the critical systems. Boards can't be expected to look at the systems infrastructure in detail – but they should have a picture of critical systems and the cyber-related exposures.</p> | <p>Avoid regarding the systems infrastructure as too operational and outside the scope of non-executive oversight. That might be the case for part of it – but where it is critical, it falls firmly to the board to understand and to satisfy itself over the quality of risk management.</p> |
| <p>Take account of the human factor when looking at the control culture in relation to cyber risks. That means taking a look at how management is establishing the right values and behaviours: the messaging, training, support, monitoring, motivation and penalties. Also the board should be asking executives about how they are reinforcing the messages along their management lines, from the CEO downwards.</p> | <p>Avoid assuming it's enough that the control processes are sound and the policies are in place. To an extent, regardless of firewalls and other defences, it's all about behaviour. The human factor will always be a weak link. Do you really want to rely on the IT department to look after this side of things? Behavioural initiatives have to be led by the CEO and executive team.</p> |
| <p>Understand the accountabilities. The board should be clear about who is responsible for what.</p> | <p>Avoid over-relying on the IT function. That might be where much of the practical defence activity is happening, but are the executives as a whole taking explicit responsibility for their areas of operations? The board should have a good picture of executive commitment and ownership for what is an organisation-wide challenge.</p> |

Richard Sheath, Director
Independent Audit Ltd

Richard Sheath is a specialist in corporate governance with expertise in the effectiveness

of boards, audit (and risk) committees, risk governance, internal audit and control culture. This article was authored by Mr Sheath with edits by Phillip Baldwin, Director, Asia,

Independent Audit Ltd, and with additional contributions from CobWeb Cyber Ltd (UK). More information is available on the Independent Audit Ltd website: www.independentaudit.com.

Rewarding the Extraordinary



The Hong Kong Institute of Chartered Secretaries Prize 2019

Call for Nominations

The Hong Kong Institute of Chartered Secretaries Prize will be awarded to a member or members who have made significant contributions to the Institute, and the Chartered Secretary and governance profession over a substantial period.

Awardees are bestowed with the highest honour – recognition by their professional peers. We urge you to submit your nominations now!

The nomination deadline is on Monday 30 September 2019.

Please visit www.hkics.org.hk or contact Melani Au: 2830 6007, or email: member@hkics.org.hk for details.

Please
act now!

Professional Development

Seminars: April 2019

8 April

Managing & sharing on practical issues of NGO governance



Speakers: Dr Ivan Yiu JP, Consultant of Governance and Management Excellence for Public Benefit; and Edith Shih FCIS FCS(PE), International President, ICSA, and Institute Past President and Executive Director & Company Secretary, CK Hutchison Holdings Ltd

10 April

New definition of permanent establishment



Chair: Jenny Choi FCIS FCS(PE), Institute Professional Services Panel member, and Associate Partner, Ernst & Young Company Secretarial Services Ltd

Speakers: Wilson Cheng, Partner, Hong Kong Business Tax Services/Tax Controversy Services; Martin Richter, Partner, Transfer Pricing Services; and Charlotte Wong, Senior Manager, International Tax Services, Ernst & Young Tax Services Ltd

11 April

Update on the law relating to search warrants and mobile devices: how to survive a dawn raid



Chair: Carmen Lam FCIS FCS, Company Secretary, Tongda Hong Tai Holdings Ltd

Speaker: Ian Childs, Partner, Stephenson Harwood

12 April

Business rescue and essential contracts in South Africa, the United Kingdom & Germany: guidance for the corporate rescue bill and Strategies to curb the abuse of insolvency proceedings in South Africa: possible lessons for Hong Kong?



Panellist: Dr Davy Wu, Senior Lecturer, Department of Accountancy and Law, Hong Kong Baptist University

and Chair: Professor Kathleen van der Linde, Professor of Corporate Law, University of Johannesburg, South Africa; and Terry Kan ACIS ACS, Partner - Specialist Advisory, Shinewing Specialist Advisory Services Ltd

15 April

Defending an SFC investigation: 2019 annual review



Chair: Daniel Chow FCIS FCS, Institute Professional Development Committee member, and Senior Managing Director, Corporate Finance and Restructuring, FTI Consulting (Hong Kong) Ltd

Speakers: Timothy Loh, Managing Partner, and Francis Comtois, Partner; Timothy Loh LLP

16 April

Be prepared for the new payroll year 2019



Chair: Polly Wong FCIS FCS(PE), Institute Qualification Development Panel Vice-Chairman, and Company Secretary and Financial Controller, Dynamic Holdings Ltd

Speaker: Joseph Hong, Director and Head of Payroll & HR Outsourcing Department, BDO Ltd

ECPD forthcoming seminars

| Date | Time | Topic | ECPD points |
|--------------|---------------|--|-------------|
| 24 June 2019 | 6.45pm-8.15pm | Handling dawn raids by the ICAC & the SFC | 1.5 |
| 25 June 2019 | 6.45pm-8.15pm | Practical guidelines to Company Law | 1.5 |
| 27 June 2019 | 6.45pm-8.15pm | Preparing industry overview section for successful IPO | 1.5 |
| 4 July 2019 | 4.00pm-5.30pm | Is your company complying with the new AML/CDD requirements? | 1.5 |
| 11 July 2019 | 6.45pm-8.15pm | Grow your business in Southeast Asia – incorporation, property and tax in Malaysia | 1.5 |

For details of forthcoming seminars, please visit the CPD section of the Institute's website: www.hkics.org.hk.

Online CPD (e-CPD) seminars

For details, please visit the CPD section of the Institute's website: www.hkics.org.hk. For enquiries, please contact the Institute's Professional Development Section: 2830 6011, or email: ecpd@hkics.org.hk.

Membership

New graduates

Congratulations to our new graduate listed below.

Kwok Kai Hung

Members' activities highlights: April and May 2019

30 April 2019

Lunch Talk – Harmonious working and family relationship



8 May 2019

Governance Professional Mentorship Programme – 1st Social Gathering



Membership (continued)

Forthcoming membership activities

| Date | Time | Event |
|--------------|---------------|--|
| 22 June 2019 | 9.30am–1.30pm | Fun & Interest Group – Dog Training |
| 4 July 2019 | 6.30pm–8.30pm | Members' Networking – Governance Challenges in Social Enterprises and NGOs |

For details of forthcoming membership activities, please visit the Events section of the Institute's website: www.hkics.org.hk.

Membership/graduateship renewal for the 2019/2020 financial year

The membership/graduateship renewal notice for the 2019/2020 financial year, together with the demand note, will be posted to members and graduates in July 2019. Members and graduates should settle the payment as soon as possible, but no later than Monday 30 September 2019. Failure to pay by the deadline will constitute grounds for membership or graduateship removal.

For enquiries, please contact the Membership Section at 2881 6177 or email: member@hkics.org.hk.

Grandfathering of Chartered Governance Professional designation

The Council has agreed to the 'grandfathering' policy for conferring the Chartered Governance Professional designation to members on a quarterly basis.

As at 31 March 2019, 4,674 (76%) out of the total membership of 6,084 have been awarded the Chartered Governance Professional designation.

Advocacy

Chief Executive as a judge for TIHK Tax Debate Competition 2019

Institute Chief Executive Samantha Suen FCIS FCS(PE) was invited by The Taxation Institute of Hong Kong (TIHK) to be a member of the judging panel for its Tax Debate Competition held on 25 May 2019.



Business School Partnership Programme – visit to Shun Tak Holdings Limited

On 29 April 2019, the Institute arranged a visit to Shun Tak Holdings Ltd for students and teachers from St Mary's Canossian College. During the visit, representatives from Shun Tak gave an overview on the development of the company, compliance issues of listed companies and the duties of a company secretary. Attendees also visited the ferry operation control centre at the Hong Kong Macau Ferry Terminal operated by Shun Tak. A sharing session was arranged as a round-up of the visit with positive feedback received from participants.



Advocacy (continued)

Networking Luncheon – Governance in the Digital Age

The Institute organised a networking luncheon for Institute members on 22 May 2019 at The Hong Kong Bankers Club. At the luncheon, Dottie Schindlinger, Vice-President of Governance Technology, Diligent, provided an overview of how technology can help boards transform governance in the digital age. Institute Chief Executive, Samantha Suen FCIS FCS(PE) also joined the speaker to discuss the steps that boards should take to prepare for such transformation. Over 50 members and guests attended the luncheon with positive feedback received.

The Institute thanks Diligent for their support.



Nominations for the HKICS Prize 2019

Nominations are now open for The Hong Kong Institute of Chartered Secretaries Prize 2019. This is an opportunity to recognise individuals who have made significant contributions to the Institute and to the Chartered Secretary and governance profession during their careers. Members are invited to submit nominations on or before the deadline of Monday 30 September 2019.

For details of the Prize and nomination procedure, please visit the News section of the Institute's website: www.hkics.org.hk.

HKICS Corporate Governance Week – mark your diary

2019 marks the 70th anniversary of the presence of The Institute of Chartered Secretaries and Administrators in Hong Kong and the 25th anniversary of the establishment of the Institute. The Institute is organising the second Corporate Governance Week (CG Week) from 16-21 September 2019 as a major event to celebrate this Double Anniversary Year. During the CG Week, a series of activities will be held, including: Stakeholder Networking Luncheon; Corporate Governance Paper Competition and Presentation Award; and Professional Development Seminars in Hong Kong and Mainland China.

For details, please refer to the CG Week flyer on page 15.

Advocacy (continued)

Academic Cocktail 2019

On 7 May 2019, the Institute celebrated its Double Anniversary Academic Cocktail in Central. Well attended by over 120 representatives from all major universities and academic institutions, as well as Institute members, Institute President, David Fu FCIS FCS(PE) thanked the academics and their respective institutions for their staunch support in promoting the Chartered Secretary and Chartered Governance Professional qualification and announced the launch of the New Qualifying Programme on 1 January 2020. Council member and Education Committee Chairman Dr Eva Chan FCIS FCS(PE) also provided updates on upcoming education-related activities.



International Qualifying Scheme (IQS) examinations

Examination postponement application

Candidates who were prevented from attending a scheduled May 2019 International Qualifying Scheme (IQS) examination may submit a medical certificate to apply for examination postponement. All applications must be submitted to the Institute on or before Friday 21 June 2019.

Syllabus update – Corporate Administration

The topic of 'Hong Kong Competition Law' has been included in the Corporate Administration syllabus (effective from the December 2018 examination diet). Students may refer to the IQS Syllabus under the International Qualifying Scheme section of the Institute's website and Chapter 14 of the Corporate Administration study pack for this new topic (Hong Kong Competition Law).

IQS study packs (online version)

The updated version of the IQS study pack for Corporate Secretaryship was made available to students from 24 August 2018 onwards. Updated versions of the other three study packs (Corporate Governance, Corporate Administration and Hong Kong Corporate Law) are also available online. A summary of the updates for each study pack can be found in the News section of the Institute's website and the PrimeLaw platform. For further questions regarding the online study packs, please contact Leaf Tai: 2830 6010 or email: student@hkics.org.hk. For technical questions regarding the PrimeLaw account, please contact Wolters Kluwer Hong Kong's customer service by email: HK-Prime@wolterskluwer.com.

Information sessions at universities

With the launch of the New Qualifying Programme (NQP) in January 2020, information sessions have been conducted with the graduating classes of partnership BBA programmes and Collaborative Courses. Information on the NQP and preparations for transition were shared with students:

Hong Kong Baptist University on 9 April 2019

Master of Science in Corporate Governance and Compliance

The Hang Seng University of Hong Kong on 12 April 2019

BBA (Hons) in Corporate Governance

Caritas Institute of Higher Education on 10 May 2019

BBA (Hons) in Corporate Management

Studentship

Professional Seminar at IVE (Tsing Yi)

Institute member Edmond Chiu FCIS FCS(PE) gave a professional seminar on the topic 'Company Secretary, an important role in Corporate Governance' to over 30 students of Higher Diploma in Corporate Administration at IVE (Tsing Yi) on 11 April 2019.



Studentship (continued)

HKICS Students Gathering

An HKICS Students Gathering was held on 10 May 2019. Institute Registrar Louisa Lau FCIS FCS(PE) shared the Institute's latest updates and New Qualifying Programme (NQP) with the participants. Ian Lee, Teaching Fellow, School of Accounting and Finance, The Hong Kong Polytechnic University, provided tips on studying the Hong Kong Corporate Law subject and Chloe Lau, Head of Publishing and Product Development, Wolters Kluwer Hong Kong, provided a brief on how to access and use the information on the PrimeLaw account, in which the Institute's study pack on-line versions are also being hosted. Participants found the sharing to be relevant and useful.



Visits to Annual General Meeting of listed companies

The Institute has arranged for some of our student ambassadors and students to attend the Annual General Meeting of the listed companies below.

- CLP Holdings Ltd on 6 May 2019
- Hutchison Telecommunications Hong Kong Holdings Ltd on 8 May 2019
- Sing Lee Software (Group) Ltd on 15 May 2019
- CK Hutchison Holdings Ltd on 16 May 2019
- China Mobile Ltd on 22 May 2019

The participants found the visits to be inspiring and informative. The Institute would like to express its sincere appreciation to the companies for their support.

The Hong Kong Institute of Chartered Secretaries Foundation Limited

HKICS Foundation Scholarship 2018-2019

HKSYU

Institute Registrar Louisa Lau FCIS FCS(PE) attended Hong Kong Shue Yan University (HKSYU) Annual Scholarship Award Ceremony on 24 April 2019.

HKBU

Institute Council member Bernard Wu FCIS FCS and Registrar Louisa Lau FCIS FCS(PE) attended Hong Kong Baptist University (HKBU) Scholarship & Bursary Donors Tea Reception on 30 April 2019.

Congratulations to the awardees of the HKICS Foundation Scholarship 2018-2019!



Passing the Torch Project 2019 – Closing Ceremony at HKUST

The Institute has partnered with The Hong Kong University of Science and Technology (HKUST) to run the 'Passing the Torch – from values of business ethics and governance to actions' project (薪火相传之商业道德与治理之行动转化) for 2019. Sponsored by The Hong Kong Institute of Chartered Secretaries Foundation Limited (the Foundation), this project aims to promote better knowledge of business ethics and corporate governance among undergraduates.

The closing ceremony was held on 26 April 2019 at HKUST where HKUST students shared their experiences and memorable moments of the school visits.



The Open University of Hong Kong (OUHK) Postgraduate Programme in Corporate Governance in Shanghai and Shenzhen

Following the successful launch of the Postgraduate Programme in Corporate Governance (PGPCG) in Shanghai by the Open University of Hong Kong (OUHK) in 2016, the Institute is pleased to announce the PGPCG of OUHK will also be introduced in Shenzhen at the Harbin Institute of Technology (HIT/哈尔滨工业大学) starting Autumn 2019. Similar to the Shanghai programme, the PGPCG in Shenzhen will also be recognised by the Institute.

To introduce the programmes, the Institute and The Open University of Hong Kong (OUHK) jointly organised information sessions in May and June 2019 to provide information of the Postgraduate Programme in Corporate Governance (PGPCG) programme offered by OUHK in Shenzhen and Shanghai respectively. The participants found the sharing on the dual Chartered Secretary and Chartered Governance Professional qualifications, route to membership, PGPCG details and the study experience were informative and useful.

From Autumn 2019 onwards, intensive weekend classes will also be held at the HIT in Shenzhen and the East China University of Science and Technology (ECUST/上海华东理工大学) in Shanghai to students who have enrolled to one of these two programmes respectively. Members, graduates and students are encouraged to forward the details of these programmes to their friends and contacts who are interested in the above programmes.



For further enquiries regarding these programmes, please contact OUHK at: (852) 2768 6940 or email: ba@ouhk.edu.hk, Ms Iona Li of the HKICS Beijing Representative Office at: (8610) 6641 9368 (ext. 228) or: email to bro@hkics.org.hk. Shanghai Programme - 孔老师 of ECUST at: (8621) 6425 1139 and Shenzhen Programme - 王老师 of HIT at: (86755) 2672 7130/7100.

Studentship (continued)

Recruitment – Examiners/Reviewers/Markers of examination papers

The Institute is now looking for subject experts who would like to contribute to the Institute's qualifying programme as examiners/reviewers/markers of examination papers.

Requirements:

1. Sound knowledge and experience in the related module(s)
2. Strong editing and writing skills
3. Experience in setting postgraduate level of examination papers and marking schemes
4. Relevant academic and/or professional qualification in the related module(s)
5. Experience as published writer is an advantage
6. Member of HKICS/ICSA is an advantage

Interested parties please send full resume to recruit@hkics.org.hk and quote 'EE_2019'.

For details, please visit the News section of the Institute's website at www.hkics.org.hk.

(Data collected will be used for recruitment purpose only).

New Qualifying Programme (NQP) – reminder

With effect from 1 January 2020, the New Qualifying Programme (NQP) will replace the current International Qualifying Scheme (IQS). The first examination of the NQP will be held in June 2020. The NQP will comprise seven modules including two electives:

- Hong Kong Company Law
- Corporate Governance
- Corporate Secretaryship and Compliance
- Interpreting Financial and Accounting Information
- Strategic Management
- Risk Management
- Boardroom Dynamics or Hong Kong Taxation (electives)

The Institute will announce details of the syllabus, reading lists, study packs and pilot papers for all the modules in the NQP to students in the near future.

For details, please visit the Studentship section of the Institute's website at www.hkics.org.hk.

If you have any queries, please contact the Education and Examinations Section at 2881 6177 or email: student@hkics.org.hk.

Policy – payment reminder

Exemption fees

Students whose exemption was approved via confirmation letter in March 2019 and April 2019 are reminded to settle the exemption fee by Tuesday 11 June 2019 and Tuesday 23 July 2019 respectively.

Studentship renewal

Students whose studentship expired in April 2019 are reminded to settle the renewal payment by 22 June 2019.



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