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Seminar 2006

Corporate Governance & Regulatory Updates

Questions for the Speakers

(Note: The following questions were submitted by participants at the seminar; the written replies were prepared by the speakers.)



Session 1

**Independent Non-Executive Directors
(INEDs): Quality and Performance
(Presentation & Panel Discussion)**

Presented by: Professor C K Low

Session 1

Independent Non-Executive Directors (INEDs): Quality and Performance (Presentation & Panel Discussion)

Presented by: Professor C K Low

Question 1: For INED Panelists – Do you agree with Prof. Low’s view that INEDs are placed at a higher standard of care as directors than Non-Executive Directors (NEDs) or Executive Directors (EDs)? What are your views in respect of this regulatory trend?

Comments from Mr Herald Lau

The highest standard of care is expected of all directors, whether EDs, NEDs or INEDs, in discharging their duties. Legally, all directors are exposed to the same liabilities attributable to their actions. INEDs have additional roles in looking after the interests of outside shareholders, especially in the case of connected transactions. This is an additional responsibility, not a higher standard of care. If this is what Prof. Low meant, then I agree. This regulatory trend is here to stay. It may be modified and refined to suit local environments. In my view, the functions of the Audit Committee, if properly carried out, are more beneficial to the company as a mechanism for check and balance as well as acting as an internal watch-dog.

Comments from Mr T Brian Stevenson

No. I reckon all directors are subject to the same standard of care. What is happening is that the responsibilities of and expectations from INEDs are becoming more specific and clearer than before.

Regarding the trend, I see it as similar to most other financial or professional regulatory matters. With time and hence more experience, regulations would become more specific in nature, and consequently the required expertise would likewise be more specific rather than general in nature.

Comments from Professor C K Low

I agree with the comments since I had suggested the same view. However I do like to add a caveat, in that there are as yet no cases on the point, even though this scenario remains a possibility given the development of the common law since *Re City Equitable Fire Insurance*. That said, the main problem for INEDs is the fact that they are under an increasing number of obligations imposed by law, regulations, rules and codes, which collectively contribute towards our increasing expectations of them that in turn will eventually translate to an increasing standard of care.

Question 2: What is the rationale behind the requirement of senior INED in the UK? (Given that there is no such similar requirement in HK)

Comments from Mr Herald Lau

With my limited knowledge, I believe that the role of senior INED in the UK is to lead and provide guidance to the other INEDs in their debate of issues among themselves, and to act as a liaison with the board. He is very much like the chairman of the Audit Committee, and very often the senior INED is also the chairman of the Audit Committee. He is usually a professionally qualified and well-experienced leader. He commands a higher remuneration than other INEDs. The board will find it convenient and efficient to have a "spokesman" for all the INEDs. Hong Kong could benefit from this if companies are willing to pay a little more.

Comments from Mr T Brian Stevenson

The rationale appears as simple as to identify a leader for INEDs who can call private gatherings of the latter and act as a focal point for their concerns.

Comments from Professor C K Low

In two words "Point Person", namely a designated person through whom matters such as whistle blowing or internal controls can be brought to the attention of the relevant committee of the board or to the board itself. Although there is no formal 'senior INED' in Hong Kong, there is some anecdotal evidence that INEDs practise this informally among themselves. Having such a person clarifies the 'chain of command' within the company, especially amongst the INEDs so as to facilitate consultations. The 'lay INEDs' may thus look to the 'senior INED' for advice and guidance, or indeed simply to be the convener of their meetings. This role is also useful to outsiders such as external auditors and suppliers as there is a "point person" to whom they can direct their queries or concerns.

Question 3: *In the Kelon case, all the INEDs were well-known persons and an international audit firm conducted the company's audit. Yet errors were still made in intangible assets. In future, for listed PRC companies, what sort of precautions should INEDs take to prevent the occurrence of similar incidents?*

Comments from Mr Herald Lau

I must refrain from commenting on individual cases, but I can say frauds and mistakes can never be eliminated even if you have the best systems, rules and regulations in the world. We all learn from mistakes and hence we introduce more rules and regulations as we go along. Training and education must be placed high on our priority list. Don't forget, only bad news is reported. Many drastic instances and situations have been prevented and corrected without making the news. I am sure there will be more "Enrons" and "Kelons" in the future while thousands make the grade with flying colours.

Comments from Mr T Brian Stevenson

Unfortunately errors will always happen, no matter how good or robust the systems of control one has in place, and no matter the quality of individuals, internal and external, dealing with a company's affairs. Such is human nature.

PRC is a developing economy. And so too are the individuals involved in managing corporate affairs. Sometimes, as a general statement, they are likely to lack the knowledge and experience available in more developed economies.

As such, when accepting the appointment as INED of a PRC company, an individual should be conscious of this. He should thoroughly investigate and understand, as best as he can, the system of controls and governance in the company before accepting appointment. Thereafter he should carry out his duties to the best of his abilities honestly and fairly, and share his knowledge and experience with his new colleagues as best as he can to the benefit of the organization.

Comments from Professor C K Low

Even the very best of regulations will not be able to completely rid us of incidence of fraud which is terribly tough to detect as well as to establish in any court of law. Furthermore, the effects are usually felt most after the fact, which means that there is often little scope for any recovery for the various stakeholders. It would not be realistic to presume that we can perhaps legislate to overcome this issue by, perhaps, imposing further layers of reporting and disclosure as the costs may outweigh the benefits. Some evidence to this end may already be adduced from the recent debate in the USA over the need to 'relax' some of the provisions of the *Sarbanes Oxley Act*. There needs to be a balanced approach, namely some 'carrot' and some 'stick': incentives on compliance and disclosure while at the same time come down very hard on those who stray.

To a lesser degree, accruals may present the same type of problems since there is bound to be active debate between the directors and the external auditors of the

company. Some aspects of 'fair value' accounting such as those set out in HKAS39 and HKAS40 may also pose problems going forward, particularly when conditions in the financial and/or property markets become more volatile. However, the responsibility should not rest with the INEDs alone as it is an issue that all the members of the board of directors should address.



Session 2

**Publications and Announcements:
Review and Update**

Presented by: Ms Susan Lo

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Comments from Ms Susan Lo

Question 1: Do I need to wait until Hong Kong Exchanges and Clearing Limited (HKEx) has published the announcement before posting the same on my corporate website and/or holding the analysts' briefing/press conference?

If we are holding a press conference or analysts' meeting after 4:15 p.m., do we need to submit the full results announcement to HKEx and post it on the website before that, i.e., can we submit the announcement by 11:00 p.m. but still hold the press conference/analysts' meeting before submission of the announcement to HKEx?

If the results announcement has not been submitted to HKEx before 7 p.m. (but the Board of Directors meeting is held after 4:15 p.m.), can the company hold any media conference, etc., after market close and before 7 p.m.?

If a company submits its announcement on or before 11:00 p.m., how fast can HKEx post on its website so that the company can release their announcement to the press (say after 11:00 p.m.) for the news to be published in the following day's newspaper? Can these be done simultaneously or does the company need to wait until HKEx has released the announcement on its website?

Does the issuer or its agents have to wait until the HKEx has posted its announcement on HKEx's website before the issuer is allowed to post the same on its own website within the allowed period?

The latest practices and arrangements for publication of results announcements by listed issuers are set out in the letter, dated 23 October 2006, of The Stock Exchange of Hong Kong Limited (the "Exchange") in relation to the "Abolition of Short-form Preliminary Results Announcements (Summary Form) for Main Board and Growth Enterprise Market (GEM) Listed Issuers". Such arrangements include, but are not limited to, the following:

- "- It is the direct responsibility of a listed issuer's directors to take all appropriate steps to ensure that price sensitive information (including results information) is kept strictly confidential until an announcement is posted on the Exchange's website.***
- Until the Results Announcements are released through the Exchange's website, to avoid selective disclosure of price sensitive information, listed issuers should not publicize their results by any other means including by way of press conferences, analysts' meetings, by publication on their own website or through transmission to newswire services."***

Listed issuers are strongly advised to follow strictly the aforesaid practices of release of results announcement or any announcement containing price sensitive information. As it is anticipated that the Exchange will take a while to post the announcement or publication on the Exchange's website, it is advisable to take this into account when uploading the announcement or publication to the issuer's own website or releasing the information to third parties.

The aforesaid Exchange's letter dated 23 October 2006 can be viewed at: <http://www.hkex.com.hk/listing/gemsharelistdoc/20061023.pdf>. Please also refer to any new rules and/or practices on dissemination of information by listed issuers that may be announced by the Exchange from time to time.

Question 2: What will be the consequences in case the issuer fails to post any notice or announcement on its own website within one hour?

Failure to publish any announcement, notice or document on the issuer's website in accordance with the requirements of the Listing Rules will amount to a breach of the Listing Rules. The actual consequences could not be ascertained until the new rules become operative.

Question 3: After the abolishment of short-form preliminary results announcement, are the new submission deadlines, i.e. 11:00 p.m. or 6:00 – 8:00 p.m. before the next business day, etc., applicable to the release of the full results announcement?

The new submission deadlines will be applicable for publication of all announcements (including the full results announcement), notices or documents required to be published by Main Board issuers on the Exchange's website in accordance with the Listing Rules.

Question 4: Will there be any suspension of trading of shares if the company fails to submit the announcement on or before 11:00 p.m. but publishes the announcement in the following day's newspaper?

Under what circumstances would the company's shares be suspended from trading for late submission?

The proposal on suspension of trading of securities of listed issuers for failure to meet the submission deadlines or to publish the short-form announcement (which will be in the form of a notification according to the Exposure Conclusion (as defined below)) in newspapers is set out in paragraphs 56 to 61 and Appendix F of the Exposure Paper on Abolition of Requirement for Main Board Issuers to Publish Paid Announcements in Newspapers and Related Matters (the "Exposure Paper") published by Hong Kong Exchanges and Clearing Limited ("HKEx") in November 2005. According to the Exposure Paper, listed issuers that are unable to meet any prescribed publication deadline must contact the Exchange at the earliest opportunity to ascertain the appropriate operational procedure to enable the information to be disseminated to the market and to avoid or minimize the period of suspension.

Question 5: Is a company listed on the Main Board required to post its notice of board meeting on HKEx's website and its own website?

According to the Exposure Conclusion on Abolition of Requirement for Main Board Issuers to Publish Paid Announcements in Newspapers and Related Matters (the "Exposure Conclusion") published by HKEx in July 2006, Main Board Rule 13.43 will be amended to require the Main Board issuers to publish an announcement at least seven clear business days in advance of the date fixed for any board meeting at which the declaration, recommendation or payment of a dividend is expected to be decided or at which any announcement of the profits or losses for any year, half-year or other period is to be approved for publication. Such announcement of board meeting shall be published on both the Exchange's and the issuer's websites according to the proposed new Rule 2.07C. However, Main Board issuers will not be required to publish a notification in the newspapers for such announcement of board meeting during Phase 1 of the transitional period.

Question 6: For Audit Committee meetings (for review of results) and INED meetings, is it mandatory to notify the Stock Exchange and publish notices of such meetings on the websites of the Stock Exchange and the company?

The Exposure Conclusion does not set out any proposal requiring the listed issuers to publish notices of meetings of Audit Committee or other board committees.

Question 7: Which rule governs the 1 hour requirement on posting announcements, etc., on the issuer's website?

Under the proposed amended Main Board Rule 2.07C(7)(a) and GEM Rule 16.19(1), any announcement, notice or document submitted by the listed issuers to the Exchange for publication on the Exchange's website in accordance with the Listing Rules must be published on the issuers' own websites within 1 hour after submission to the Exchange, save and except where such announcement, notice or document is submitted to the Exchange after 7:00 p.m., the publication on the issuers' own websites must be no later than 9:00 a.m. on the next business day following such submission.



Session 3

Disclosure of Interests under Part XV of Securities and Futures Ordinance (SFO): an Overview

Presented by: Ms Betty Yeung

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Presented by: Ms Betty Yeung

Comments from Ms Betty Yeung

Question 1: Who is classified as a “qualified lender”?

Pursuant to section 308 of the Securities and Futures Ordinance, "qualified lender" means "a person who is -

- (a) an authorized financial institution;
- (b) an insurer authorized under the Insurance Companies Ordinance (Cap 41);
- (c) an exchange participant of a recognized exchange company;
- (d) an intermediary licensed or registered for Type 1 or Type 8 regulated activity; or
- (e) a corporation authorized under the law of any place outside Hong Kong recognized for the purposes of sections 313(13), 317(6), 323(6) or (7) or 341(5) by the Commission to carry on business -
 - (i) as a bank;
 - (ii) as an insurance company; or
 - (iii) in an activity that is in the opinion of the Commission equivalent to any of the regulated activities carried on by an intermediary referred to in paragraph (d)".

Note: "Commission" means "Securities and Futures Commission".

Question 2: When share options of a Director become lapsed, is he still subject to the disclosure requirement?

A director will cease to have an interest when the share options granted to him (and remain unexercised) lapse, and he shall thereupon be subject to a duty of disclosure in respect of the cessation of interest.

Question 3: What is “qualifying bonus or rights issue”? Please give some examples.

A “rights issue” is defined in section 308 of the Securities and Futures Ordinance as follows:

“An offer or issue by a listed corporation of shares in the listed corporation (whether issued or un-issued) to all persons holding issued shares in the listed corporation at a certain date (other than a person whose address is in a place where such offer or issue is not permitted under the law of that place) in proportion to the number of those issued shares held by them at that date, but does not include an offer or issue of shares in the listed corporation in lieu of all or part of a cash dividend.”

In addition, according to the SFC's Outline of Part XV, a "rights issue" covers offers or issues by listed corporations to all shareholders in proportion to the number of shares held by them at a given date. It covers most issues referred to as "rights issues" and "bonus issues" but not, for example, convertible bonds.

A shareholder will be exempt from making disclosure on taking up rights under qualifying bonus and rights issues so that the percentage level of their interests will remain the same. Hence, shareholders who do not take up their rights will have to make a disclosure, as the percentage level of their interests will change.

Question 4: If a director has made notification of Disclosure of Interest in a listed company, does he need to make notification if he retires from the listed company, or changes in % of holding in that listed company?

When a director retires from a listed company, he shall no longer be subject to the disclosure obligations under the Securities and Futures Ordinance, save and except if he holds 5% or more of the discloseable interests. The current rules and notification forms do not provide for such event of cessation of directorship.

Under the "Consultation Paper" and "Consultation Conclusions" on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance published by the Securities and Futures Commission in January and May 2005 respectively, it is proposed that more codes will be added to the notification forms to identify events that give rise to the disclosure and the capacity in which interests and short positions are held. These will include codes for, inter alia, director becoming or ceasing to be a director.

Question 5: Substantial shareholder A is required to file a SFO form due to a 5% deemed interest arising out of an agreement with substantial shareholder B – Shareholder A is not required to pay for this 5% interest as shareholder B has paid it in fact. Does shareholder A have to fill in the consideration amount in the SFO form?

We are not able to provide an answer without full details of the situation.

Question 6: Please elaborate on slide 7 pt 1: beneficial ownership in voting shares un-issued.

To illustrate by way of example, a discloseable interest in un-issued voting shares may exist when a person has interests in the underlying voting shares of subscription warrants and share options.

