

Speech by SJ at Speaker Luncheon Meeting of Hong Kong Institute of Directors (English only)

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Following is the speech by the Secretary for Justice, Mr Paul Lam, SC, at the Speaker Luncheon Meeting of the Hong Kong Institute of Directors on the role of company directors in maintaining the competitiveness of Hong Kong today (August 5):

Dr To (Chairman of the Hong Kong Institute of Directors, Dr Christopher To), members of the Hong Kong Institute of Directors, distinguished guests, ladies and gentlemen,

Good afternoon. Firstly, I am very honoured to be able to join you today at this luncheon talk. In particular I am very grateful to Dr To. I remember that not too long ago when we were on a trip to the Middle East, he suggested perhaps I could attend one of the events organised by the Hong Kong Institute of Directors, and asked whether I am interested. And of course, I said yes.

I wish to focus on something which may be of common interest to directors. I know you come from very diversified backgrounds. Some of you work in private companies. Some of the directors are senior officials of NGOs (non-governmental organisations) and I know that there are representatives from statutory bodies. So it is not easy to find something which might be of common interest.

I have decided to share my thoughts on the role of company directors in maintaining the competitiveness of Hong Kong. It is a fairly long title, but I think the idea is to share my views on, in your respective capacity of director, what we can do, what are the things that we should pay attention to, at this particular moment, in order to keep Hong Kong being a very competitive economy.

The rule of law as the support of Hong Kong's status of an international business centre

I am going to start with something that we should be very proud of. As the Secretary for Justice, I have to start with the rule of law. One of the famous quotes by President Xi Jinping is that, he said the rule of law is the best business environment, 法治是最好的營商環境. I think if you look at the statistics and surveys, there are very good reasons for us

to be very proud of the status of the rule of law in Hong Kong. And I would like to give you some facts and figures.

Over the past decade, Hong Kong has ranked among the top seven most competitive economies in the world. In the World Competitiveness Yearbook 2024 published by the IMD, International Institute for Management Development, in June this year, Hong Kong's overall ranking rose from seventh to fifth globally. Yes, we used to be in the first position, but we are catching up. I think we are climbing back to our old position. And in particular, Hong Kong was ranked as first in the sub-factor of "International Trade" and third in the sub-factor of "International Investment" under the category of "Economic Performance". And I think this is the reason why Hong Kong has always been rightly recognised as an international business centre.

And it is also a very important reason why the Central People's Government supports Hong Kong to continue to play the role as an international financial and trade centre in various national development plans, for example, the National 14th Five-Year Plan. It is also what the Chief Executive has mentioned repeatedly in his Policy Address, including the one in 2023. And of course, one of the reasons which contributed to the success of Hong Kong is its rule of law. And again, I wish to give you some facts and figures.

Hong Kong is the only jurisdiction within our country which practices the common law. I wish to give you the historical context to see how things have changed since the resumption of sovereignty in 1997. Back in 1996, Hong Kong's percentile rank for rule of law in the World Bank's Worldwide Governance Indicators was just 69.85 and ranked fifth in Asia. In 2023, we scored 87.74 and ranked third in Asia. So after 20-odd years, there is no doubt whatsoever that our rule of law has improved.

According to the 2023 World Justice Project Rule of Law Index released in October 2023, Hong Kong was ranked the sixth in East Asia and the Pacific, and it is the 23rd out of 142 countries and jurisdictions worldwide. In particular, in terms of "Order and Security", we are the sixth in its global ranking. We also rank ninth globally for "Absence of Corruption", which demonstrates the efforts made by the law enforcement agencies, in particular the ICAC (Independent Commission Against Corruption) in combating corruption and other malpractices.

More recently, in the World Competitiveness Yearbook 2024 which I have just

mentioned, Hong Kong came third under the category of "Government Efficiency", and remains number one in the sub-factor of "Business Legislation". Under the sub-factor of "Institutional Framework", we rank third for "Legal and Regulatory Framework" and fourth under the "Bribery and Corruption Do Not Exist" category. Respondents to the survey take the view that effective legal environment is one of the top three key attractiveness indicators of the economy of Hong Kong.

All these indicate that the rule of law in Hong Kong is in a very healthy and robust state, making us on par with, if not ahead of, many countries in other parts of the world, some of them for various reasons keep on making criticisms or negative comments against Hong Kong.

But notwithstanding the fact that I truly believe that we are doing very well, there is definitely no room for complacency. And returning to what I intend to say or focus on is that: how can we ensure that we will remain in a top position in so far as the rule of law is concerned? I was inspired by the indicators used by the World Competitiveness Yearbook, and I wish to focus on two factors only. Firstly, the importance of business legislation, and secondly, the importance of ensuring that bribery and corruption do not exist, because these two factors are of great relevance and importance to your capacities as directors.

#### Business legislation and directors' duties

Firstly, the business legislation. I am sure that we all agree that business legislation is a very significant factor when it comes to making business decisions. For example, business regulations ensuring low trade barriers would attract foreign investment, and company law, competition legislation and labour regulations and so forth would affect the convenience or the ease of entry into any particular markets. In fact, in the World Competitiveness Yearbook 2024, under the sub-factor of "Business Legislation", we rank first for "Tariff Barriers" for the lack of, or absence of, tariff barrier, third in "Competition Legislation" and "Labour Regulations". All these supported our economy's strengths: pro-businesses, open and fair.

Under business legislation, which I would regard as including not just the business law and statutory law but include also regulations and rules and practices, accountability is certainly a very key element. Corporate governance and directors' duties are safeguards

to shareholders' interests and rights, as well as boosters of investor confidence. As we all know, under Hong Kong law, directors' duties derive from different legal sources, for example the constitution, memorandum and articles of association of the company, judicial decisions and also statutes, so on and so forth. General principles would of course include a general fiduciary duty, the duty to act in good faith for the benefit of the company as a whole and duty to exercise reasonable care, skill and diligence. I am not going to give a law lecture on the content of directors' duties because I am sure that you are very familiar with these laws and regulations, but I do wish to emphasise that the significance of these duties, and highlight some recent developments which will have important bearing on your work.

Hong Kong is a major global listing platform and is home to a lot of multinational institutions. Apart from statute law like the Companies Ordinance (Cap. 622), you must be aware that directors of listed companies in Hong Kong are subject to rules and regulations including the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the Listing Rules. Listed companies are also subject to the Corporate Governance Code and the requirements of the Environmental, Social and Governance Reporting Guide, the ESG Reporting Guide. Now, this is the area that perhaps I would like to say a few words.

All of these laws and regulations lay a very solid foundation for economic development and structural support. For them to remain effective, it is of crucial importance to ensure that our laws and regulations align with international standards which can meet the ever-changing needs of investors and businesses. On this point, I wish to highlight a few latest developments in directors' duties concerning ESG, Environmental, Social and Governance.

I suppose many of you are very familiar with the recent developments, but I feel it is perhaps necessary and worthwhile to repeat some of these recent developments. ESG elements such as environmental protection, ethics and data privacy are increasingly integrated into investors' due diligence and decision-making. It is becoming a significant indicator of the effectiveness of the risk management and the long-term sustainability of a company. A company with a comprehensive and well thought-through ESG strategy would attract investment and facilitate sustainable development.

Back in November 2022, I note that the Hong Kong Chartered Governance Institute

published a paper on "Legal Developments in Directors' Duties and ESG: What Every Hong Kong Company Director Should Know". The paper started off with a critical point: "Directors' duties have developed over many years and are constantly evolving." The ESG regulatory landscape in Hong Kong has indeed evolved very rapidly, and is still evolving.

ESG regulations in Hong Kong have been introduced by the Hong Kong Stock Exchange (the Stock Exchange), the SFC (Securities and Futures Commission) and the Hong Kong Monetary Authority (the Monetary Authority). The ESG Reporting Guide was first introduced in 2013 by the Stock Exchange requiring directors to express that they have the overall responsibility for the company's ESG strategy and reporting. Mandatory disclosure requirements relating to the company's ESG governance structure and reporting are also imposed under the Listing Rules. In 2022, the Corporate Governance Code was amended by the Stock Exchange to require directors to consider ESG risks as part of their annual review of the listed company's risk management and internal controls systems. In the same year, the SFC amended the Fund Manager Code of Conduct integrating fund manager's governance, investment and risk management processes with climate-related risks, and imposing disclosure obligations of such policies and procedures. Meanwhile, the Monetary Authority introduced a new module called "Risk-based supervisory approach" to its Supervisory Policy Manual to encourage authorised institutions to consider climate risks.

With more ESG rules and regulations, ESG-related litigation have emerged as well. Although ESG-related litigation is still not common in Hong Kong, as the international community place more emphasis on environmental protection and social responsibilities, directors should be aware that ESG-related litigation may bring about significant potential financial and reputational damage to companies, and the impact could go beyond domestic scale. According to the report of "Global Trends in Climate Change Litigation: 2024 Snapshot" issued by the Grantham Research Institute on Climate Change and the Environment of the London School of Economics and Political Science, 2 666 climate litigation cases have been captured in the Sabin Center for Climate Change Law's Climate Change Litigation Databases, and more than 230 cases were filed in 2023. Regardless of the global trend, companies should always comply with applicable ESG requirements. "Greenwashing", which means giving false information or representations of companies' environmental friendliness, would run both litigation and reputational risks.

In fact, I wish to digress a little bit because I just came back from Singapore not too long ago, and I took part in a forum attended by the Chief Legal Advisors of countries around the world, in particular in Asia. A topic that we discussed concerned investor-state dispute resolution. And in fact a lot of discussions spent on provisions in investor-state treaty in which environmental policy would have an implication. So potential litigations on issues concerning or in relation to climate change and environmental protection would definitely become a more significant role in the future, both at the domestic level and perhaps at the international level.

To promote the competitiveness and development of Hong Kong, I understand that the Stock Exchange has made further efforts to enhance corporate governance standards. In April 2024, the Stock Exchange published its consultation conclusions for introducing new disclosure requirements for listed companies on climate-related matters. These new disclosure requirements align with the climate-related disclosures published by the International Sustainability Standards Board, including requiring issuers to disclose specific individual(s) or body(ies) that are responsible for the oversight of climate-related risks and opportunities, analyse climate-related risks, opportunities and impact on the issuers' business.

And once again, I wish to digress a little bit. In June 2024, the Stock Exchange published a consultation paper on the Corporate Governance Code improving, amongst others, board effectiveness, independence and diversity. For example, a lead independent non-executive director (INED) must be designated if the board chair is not independent, INEDs serving more than nine years will no longer be considered independent - I noted that a lot of controversy about this particular proposal, and the nomination committee is required to be comprised of directors of different genders. The Stock Exchange also proposes to impose enhanced disclosure requirements of an issuer's dividend policy and its board's dividend decisions. I would certainly encourage you to take your time to consider the consultation paper. And I know that the consultation period will end next week, on August 16, 2024.

Legislation and regulations definitely play a very important role in providing structural support and promoting economic development. To address the evolving concerns and needs of businesses and investors, directors should always keep abreast of these latest development in compliance, and pay regard to various legal and ESG

considerations when discharging their duties under Hong Kong law.

So the point that I wish to make is quite simple. Let's forget about the details. But it is of crucial importance to first ensure that our business legislation in the broad sense is up to date, in a sense that it is consistent with and it is aligned with the expectations of the international community. And secondly, as directors, we have to ensure that all these regulations and rules are not simply up to date, but they will be strictly complied with in our daily operation.

### Clean business environment

Now moving on to the second factor that I regard to be of extreme importance to Hong Kong is to maintain a very clean business environment. With effective anti-bribery and corruption measures, companies can conduct businesses fairly. The importance of "zero tolerance of corruption" has been highlighted in the whitepaper entitled "The Belt and Road Initiative: A Key Pillar of the Global Community of Shared Future" published by the State Council of the People's Republic of China last year. You are all very familiar with the Belt and Road Initiative, and the Belt and Road Initiative, or the Silk Road, has been described in various ways. But one of the characteristics that our country, China, has emphasised, is that it must be a clean silk road, a road which is free of corruption. So that highlighted the importance of maintaining a very clean business environment. Fortunately, apart from the rule of law, I think the absence of corruption is definitely another indisputable strength of Hong Kong.

We have been recognised, for example, in the World Justice Project's 2023 Rule of Law Index, as I have mentioned earlier, Hong Kong ranked ninth under the factor of "absence of corruption" out of 142 jurisdictions, and we rose from 10th to fourth, topping the Asia-Pacific region under the indicator "Bribery and Corruption Do Not Exist" in the World Competitiveness Yearbook 2024. I think these rankings not only reflect that our success in anti-corruption work, but also the growing confidence of foreign or international investors in Hong Kong's overall environment.

In fact, anti-bribery and corruption is embedded also in the fiduciary duties of directors under Hong Kong law. The duty to act in good faith for the benefit of the company as a whole means that a director owes a duty to act in the interests of the shareholders of the company. Other examples include the duty to use powers for a proper

purpose for the benefit of the company and the duty to avoid conflicts between personal interests and interests of the company. A director of course must also bear in mind not to use his position to gain advantage for himself or others to the detriment of the company. And all these are part and parcel of the very fundamental fiduciary duty on the part of directors.

Although what I am going to say is maybe very obvious, but it is always important to remind ourselves, and also to remind our colleagues of the potential legal consequences. I think there are three legal consequences in this respect that must always be borne in mind.

Firstly, directors may face potential criminal liabilities. Directors involved in corrupt or improper matters or any sort of malpractice, may face penal consequences, including, of course, imprisonment. For example, we are well aware of the Prevention of Bribery Ordinance, section 9, makes it an offence for an agent who solicits or accepts an advantage, without the permission of his principal, as an inducement to or reward for his doing or forbearing to do a certain act, so on and so forth. Offering an advantage to an agent for the same purposes is also an offence. The maximum penalty is seven years' imprisonment. I am not saying all these things to scare you, but it highlights how serious Hong Kong takes corruption. The Court can also order that person to pay the amount or value of any advantage received, and prohibit him or her from taking up employment as director or manager of a corporation or a public body. So the first is criminal liabilities.

The second is regulatory consequences, for example, disqualification orders under section 214 of the Securities and Futures Ordinance. Under that particular provision, the Court may order a person to be disqualified from acting as a director or taking part in the management, directly or indirectly, of a company for up to 15 years.

And lastly, there may be civil liabilities. There is a legal principle laid down by judicial decision that a fiduciary who accepts a bribe in breach of duty holds the bribe on constructive trust for the principal. In the context of a company, this means that a director who accepts any such improper advantage will need to account for what he has received, including paying the amount or value of the advantage received or returning the property obtained.

I am sure that all of you will not commit this kind of misconduct, but that is not



sufficient. The point is to ensure that all other colleagues, directors and other senior officials and employees in your company will equally recognise the importance of complying with these laws and regulations. This is because good corporate governance should impose anti-bribery and corruption framework on employees, and the duty of directors to exercise reasonable care, skill and diligence may well include taking reasonable steps to devise and implement an internal framework so that employees and staff members could also contribute to create a very clean business environment. I believe that anti-bribery and corruption also form part of the social aspect of ESG obligations of companies. Therefore, to fulfil directors' duties and ESG obligations, companies should establish and implement best practices and guidelines on requiring employees to uphold professional conduct, including openness, fairness, honesty and integrity. Internal compliance procedures in relation to confidentiality, declaration of conflicts of interest, pre-trading approval and entertainment expenses and similar expenditures should also be set and followed to avoid deception, corruption and other malpractice.

As a starting point - because I am also sitting as a member of the ICAC Operations Review Committee so I am very familiar with the work of the ICAC, and it is also something that I believe many of you are quite familiar with - companies may refer to the codes of conduct and corruption prevention guides published by the ICAC. They also provided very useful courses to assist company directors and senior officials to comply with these very important duties. These guides set out the basic standards of conduct expected of directors and staff of private companies and provide guidance to companies in different sizes in developing and effectively implementing governance and internal control measures. Documents published by the Stock Exchange, the SFC and the Monetary Authority such as the Corporate Governance Code and the ESG Reporting Guide which I have mentioned also contain some practical tips in this respect.

As an internationally renowned financial and trade centre, I am sure that you would agree with me that corruption is not tolerated in Hong Kong. So, zero tolerance. To maintain Hong Kong's competitiveness and to promote sustainable development, and I believe to maintain a very clean and corruption-free culture and business environment is of utmost importance.

These are that the two points that I wish to impress on you. We may take things for granted because what I have just said is nothing new. You are very familiar with director's duties, very familiar with the need to ensure our business laws and regulations

will be kept up today, strict compliance with ESG requirement, no corruption. Many things are easy to say, but not very easy to practice and to ensure that it will continue to be practiced 100 per cent in the interest of Hong Kong. And as directors, I do encourage you to take these duties seriously, as it is always the case, because among other things, these are two very important factors which distinguished Hong Kong from many other competitors and these two factors are also the essential components of our rule of law. So, these are perhaps the very small points that I would like to share with you today. I apologise for not saying something more interesting. Thank you.

Ends/Monday, August 5, 2024