Corporate Governance
and Governance Professionals
In Hong Kong/China:

Upping the Game

June 2023

FOREWORD

The need for good governance is more crucial than ever as the world continues to evolve at an unprecedented pace, requiring the address of a vast array of governance concerns at both national and transnational levels. In this context, the role of governance professionals has grown in importance as they work to keep organisations sustainable, compliant, and relevant in the face of constant regulatory change.

Companies face various challenges, such as rising stakeholder expectations, the need to manage complex regulatory requirements, and increasing demands from their organisations. In this fast-paced environment, they must continuously learn, improve, adapt to new technology and methods, and stay one step ahead of the curve.

This research report aims to shed light on current issues, problems, and best practices in governance in Hong Kong and the Mainland. The Institute's mission is to motivate governance professionals to elevate or up their game, take on more significant leadership and influential roles within their organisations, and advance governance best practices.

By incorporating the techniques and solutions discussed in this research report, governance professionals can be empowered to improve their abilities, expand their networks, and contribute more to their organisations. Furthermore, fostering continued communication and cooperation between governance professionals, regulators, and other stakeholders is essential for advancing good governance and cultivating a culture of excellence.

I encourage you to study this research report and join us in the ongoing development, expansion, and innovation journey. Let's collaborate to build 'better governance, better future.'

Ernest Lee FCG HKFCG(PE)
President
The Hong Kong Chartered Governance Institute

EXECUTIVE SUMMARY

Regulations, the complexity of the economic environment, geopolitics, and other factors present increasing governance challenges for chairpersons and boards on both a national and transnational scale. This research looks at the growing responsibilities of company secretaries as governance professionals to address these challenges. Therefore, chairpersons and board members should be interested in the analysis of this report and the need to empower company secretaries/governance professionals to support them.

To illustrate the extent to which these challenges affect corporate governance, this paper takes the Hong Kong context, covering the latest developments in the region and discussing issues that resonate for companies worldwide.

The five significant areas of discussion are:

1. Hong Kong and the Greater Bay Area;
2. The COVID-19 Pandemic and Corporate Resilience;
3. Macro and Micro Challenges in Corporate Governance;
4. Climate Change, the Carbon Emissions Market, and Environmental, Social, and Governance (ESG);
5. Digital Transformation, Emerging Technologies and Digitalisation (The Role of RegTech and Social Media).

In summary, company secretaries/governance professionals in Hong Kong should:

- Keep up-to-date with global economic, regulatory, and socio-political changes while deepening their business connections across the border to be ‘in the loop’ with what is happening in key GBA cities. Similarly, the skillset of appreciation of subtle cultural differences should not be overlooked, and this will necessitate developing a combination of technical, commercial and social skills.

- Engage stakeholders inside and outside the company while understanding the current distinctive characteristics of a dual economic identity of Hong Kong and the Mainland, which has been the winning formula for much of the territory's economic growth.

- Assist boards in managing risks and drawing up business continuity plans to deal with possible fallouts or eventualities for resilience. Boards must therefore delegate formal duties to the appropriate authority to the company secretary/governance professionals.

- Become knowledgeable and address matters concerning climate change and ESG as a vital part of their core duties to inform and advise the board. Furthermore, they need to assist in formulating company policies and overseeing compliance on related topics as an integral part of the role.

- Acquire general knowledge to advise the board on digital transformation, technological and other related risks, and assist in formulating plans. This can be enhanced by active participation with key stakeholders to appreciate technology's impact on the company's governance.

Overall, the Institute should work towards promoting the company secretary/governance professional to the role of Chief Governance Officer (CGO), which will lift the level of professionalism, public standing, and broader business community respect and also explore the continuous training of company secretaries and governance professionals. This report covered many challenges, and there is a clear need for company secretaries/governance professionals to upskill further. These skills and knowledge building blocks could cover the following:

- Crisis management and business continuity management
- Digital literacy and competence (including basics on AI)
- Cyber security management
- Climate risk management
- Mainland business and related laws

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ACKNOWLEDGEMENTS

This project is supervised by the Institute's Technical Consultation Panel (**TCP**) with Mrs April Chan FCG HKFCG as Chairman. Mohan Datwani FCG HKFCG(PE) Institute Deputy Chief Executive serves as secretary to the TCP and contributing editor to this research report. The Institute expresses gratitude to Mr Ernest Lee FCG HKFCG(PE) Institute President and Ellie Pang FCG HKFCG(PE) Institute Chief Executive for their contributions to the project. The Institute is also grateful to TCP members and the authors, Dr Angus Young, Dr James McCalman, and Professor Aris Stouraitis, assisted by Ms Jessa Alfajardo.

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McCalman, J., Paton, R.A. and Siebert, S. 2016. *Change Management: A Guide to Effective Implementation (4th edition),* Sage Publishers, London.

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The authors would like to acknowledge the fine work and contributions in this project by Ms Jessa Alfajardo, Research Assistant at HKBU Business School.

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INTRODUCTION

Regulations, the complexity of the economic environment, geopolitics, and other factors present increasing governance challenges for chairpersons and boards on both a national and transnational scale. This research looks at the growing responsibilities of company secretaries as governance professionals to address these challenges. Therefore, chairpersons and board members should be interested in the analysis of this report and the need to empower company secretaries/governance professionals to support them.

Change is inevitable, and this applies as much to governance professionals as they cope with ever-increasing demands. The Chartered Governance Institute's global representation of governance professionals has identified some of the work areas affecting governance professionals. These include the growth of virtual or hybrid meetings, the change to flexible work practices, and changes in organisational attitudes caused by risks associated with the pandemic[1], which has started an inevitable trend towards digitalisation that is unlikely to backtrack.

Likewise, themes related to the pandemic in Hong Kong and the Mainland continue to exist. Additionally, companies are confronted with issues related to the integration and development of the Greater Bay Area (GBA); digital transformation and emerging technologies; increased regulatory demands and requirements in their environmental, social, and governance (ESG) practices; climate change; as well as geopolitical tensions.

Governance professionals play an essential role in implementing good practices and offer invaluable advice and support to company boards, including navigating the governance aspects of these issues.[2] While the traditional role of the company secretary/governance professional has been to ensure statutory compliance, recent trends have added new responsibilities. For example, risk monitoring, strategic resilience and stakeholder engagement are necessary to deliver positive governance outcomes.

It is also worth noting that recent changes to the company secretaries and governance professionals' qualifying examinations included two new modules: risk management and board dynamics. Therefore, it will not be unreasonable to expect company secretaries/governance professionals to take a more active role in risk management and to act 'as a vital bridge between the executive management and the board and facilitating the delivery of organisational objectives.'[3]

This development aligns with the Chartered Governance Institute's competency framework in 2022, which states that 'effective company secretaries and governance professionals enable the board to set and achieve the strategic goals of the organisation. This requires specialist knowledge combined with strong values, emotional intelligence and the ability to apply understanding in the particular context of the organisation and its wider environment.'[4]

Also, 'the role of the company secretary or governance professional has grown significantly, from technical expert to strategic enabler. Skilled professionals who can engage with stakeholders successfully and balance regulatory compliance with their organisation's commercial interests and social purpose are in high demand.'[5]

We emphasise the new challenges governance professionals face and seek to bring awareness and appreciation towards their role in supporting the leadership of a 21st-century company. It is not intended as a complete checklist of the duties of governance professionals but rather as a review of the challenges they face in fulfilling their new role in the modern company. In this sense, it is essential to understand how company secretaries/governance professionals can help the board navigate these issues, deliver updated information and insights, and be trusted adviser.

1 The Chartered Governance Institute, 'The impact of Covid-19: a multi-jurisdictional assessment', October 2022 (https://www.cgiglobal.org/media/gg2jslev/cgi_covidreviewpaperfinalmci.pdf)

2 Chan, R. S. Y., Ho, D. and Young, A., (2018) 'Perceptions about the role of the company secretary in Hong Kong: from creature of the law to independent professionals?', *Company Lawyer*, Vol. 39, Issue 6, pp. 201-8

3 The Chartered Governance Institute, 'The Company Secretary: Building Trust through Governance' (https://www.cgi.org.uk/knowledge/research/the-company-secretary-report)

4 The Chartered Governance Institute, 'The Competency Framework: Enabling Good Governance', p. 1. (https://www.cgi.org.uk/assets/files/competency-framework/cgiuki-comp-framework-24pp-rgb.pdf)

5 Ibid.

Section 1:

Hong Kong and the Greater Bay Area

The development of the Greater Bay Area (GBA) is a recent plan by China's Central Government to connect the two Special Administrative Regions of Hong Kong and Macao and the nine municipalities into a modern commercial powerhouse forming an estimated total area of 56,000 sq. km, with a total population of 86 million and a GDP of USD1.7 billion in 2020. This development is a key strategic plan to drive innovation and a significant step in China's commitment to reform. Deepening cooperation aims to achieve synergy, economic development, and closer integration. By doing so, the initiative aims to form an area that will serve as an ideal destination for travel, work and living. Hong Kong has an essential role in developing the GBA project, being its most open and international city with a reputation as a financial hub and professional services. The 'One Country, Two Systems' regime can enhance the function of the GBA within and connect it with the outside world to support the country's economic development and needs.[6] The GBA's 'Outline Development Plan' allows Hong Kong to integrate and bring new growth opportunities to various sectors.[7]

1.1 Hong Kong's contributions to the Greater Bay Area

Hong Kong plays a significant role in developing the Greater Bay Area in two ways:

i. The unique corporate governance structure in Hong Kong

This allows it to develop a pluralistic corporate governance framework in the GBA. Corporate governance in Hong Kong follows a unique combination of international standards and consideration of the family- and state control of most publicly-listed companies.[8] Local family-dominated listed companies in Hong Kong are subject to what is often referred to as a family-centred governance model. While listed companies are subject to mandatory requirements for disclosure and 'comply or explain' provisions as described in the Corporate Governance Code,[9] there are also companies so profoundly rooted in Chinese culture and values which lag in corporate governance standards. The family-centred governance model embeds Chinese cultural influences that affect the mindset and shape the behavioural tendencies of company directors in these companies. Given Hong Kong's size, factors such as friendship and trust also play important roles in the governance of these firms.

On the other hand, mainland state-owned enterprises (SOEs) emphasise the interests of stakeholders rather than solely serving shareholder interests. The corporate governance environment in Hong Kong has to consider these unique characteristics while simultaneously meeting international standards. Thus, one of Hong Kong's potential contributions to the Greater Bay Area could be the development of a corporate governance framework that recognises these unique characteristics while at the same time catering to international corporations or large local companies with foreign shareholders.[10]

Hong Kong has a well-established common law regime, a sound rule of law, high transparency and integrity, and internationally-benchmarked regulatory systems, which are attractive to international investors and mainland firms.[11]

6 Guangdong-Hong Kong-Macao Greater Bay Area, 'Overview', *bayarea.gov.hk* (https://www.bayarea.gov.hk/en/about/overview.html)
7 Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area (https://www.bayarea.gov.hk/filemanager/en/share/pdf/Outline_Development_Plan.pdf)
8 Fong, E., 'The Importance of Corporate Governance for an International Financial Centre', *Securities and Futures Commission*, 09 September 2008 (https://www.sfc.hk/-/media/doc/EN/speeches/speeches/08/ef_20080909_1stalcc.pdf)
9 HKEX, 'Appendix 14: Corporate Governance Code', *Rules and Guidance*, 31 December 2021 (https://en-rules.hkex.com.hk/rulebook/introduction-8)
10 Young, A.,2014, 'Family Business and Corporate Governance in Hong Kong', Wolters Kluwer Hong Kong Ltd
11 The Association of Chartered Certified Accountants, 'Greater Bay Area Opportunities – Capitalising Hong Kong's Unique Edge'

ii. Capital funding for GBA initiatives

Another area where Hong Kong can contribute to the GBA's development is by raising funds to support initiatives on technology and innovation. The *Outline of the 14th Five-Year Plan for the Economic and Social Development of the People's Republic of China and the Long-Range Objectives Through the Year 2035 (the 14th Five-Year Plan)* reiterates the importance of Hong Kong in the overall development of China due to its position not just in the four traditional areas of being an international financial centre, shipping centre, centre for commerce and trade, and centre for legal and dispute resolution services in the Asia-Pacific region, but also in four emerging areas as an international aviation hub, innovation and technology hub, a regional centre for intellectual property trading, and a global centre for cultural and art exchange.[12]

Hong Kong's position and Shenzhen as among the world's top 50 cities in the Global Startup Ecosystem Index Report 2021 provide a robust start-up ecosystem in the GBA. The business environment and the flow of information and capital in Hong Kong are rated highly by start-ups in Shenzhen. Hong Kong's access to international markets also makes the city an ideal starting place to make global connections. Furthermore, Hong Kong's ability to attract research institutions and world-class universities allows it to strengthen coordination and commercialise its research, along with Shenzhen's national-level 'R&D facilities' and 'R&D talent availability'. Thus, by developing Hong Kong into a global innovation and technology hub, along with its recent pledge of cooperation on investment promotion with Shenzhen, the GBA's high-tech potential and opportunities can be further maximised.[13]

Sound corporate governance is one of the main factors that makes Hong Kong successful as an international financial centre. It has a legal system that adheres to international practices and relevant regulations that specify company directors' duties, clarify transactions among them and set out provisions that regulate their behaviour to protect investors.[14] A sound corporate governance system helps build confidence among stakeholders and investors, which will help raise funds from various channels, such as through initial public offerings, bond issuance, or private equity placements. To get funding and support from the international community, listed companies in Hong Kong must first meet the latest international standards, norms and rules.

12 This paragraph draws on Tsang, A. and Yim, S., 'Exploring the Greater Bay Area Start-up Ecosystem', *HKTDC Research*, 15 November 2021 (https://research.hktdc.com/en/article/OTAzMDI1MTk2)

13 InvestHK, 'Hong Kong and Shenzhen sign MOU on investment promotion co-operation', gba.investhk.gov.hk, 23 June 2022 (https://gba.investhk.gov.hk/en/news-and-events/hong-kong-and-shenzhen-sign-mou-investment-promotion-co-operation.html)

14 This paragraph reflects Solicitor Alan Lau of the Law Society of Hong Kong in Chu, W., 'Good Corporate Governance Among Keys to Financing Opportunities', *HKTDC Research*, 08 November 2019 (https://research.hktdc.com/en/article/MzM1NDQwNTk3)

1.2 Potential risks for Hong Kong

While the opportunity to integrate into a larger economy is a benefit, there is a risk that the rapid development in the GBA may cause Hong Kong to lose its distinctiveness and weaken its function as a gateway to Mainland China. The Mainland economy significantly impacts Hong Kong's economic growth due to trade and investment flow. Better infrastructure and joint economic activities will allow for faster movement of people within the GBA. Skilling and Low (2021) argue that regional integration may also increase the risk for small economies like Hong Kong, as workers and firms could leave to seek opportunities in the larger market.[15] Hence, it is important to set policies that will safeguard distinctiveness by investing in skills, human capital, innovation, and other areas that form core competitive advantages.

Hong Kong is recognised as an excellent gateway for international businesses to the GBA and the larger Mainland market. For example, major financial institutions such as the Swiss lender Julius Baer, the UK's Standard Chartered, and the American JPMorgan are considering expanding in the GBA through Hong Kong.[16] Hence, it is unsurprising that resources and guidebooks are being prepared for international firms that plan to scale up activities, such as the investment guidebook compiled jointly by Invest Hong Kong (InvestHK) and PwC.[17] In addition, PwC South China and Hong Kong Tax Leader, Charles Lee, advises firms to adopt a 'GBA mindset' when it comes to talent pooling and nurturing, tapping new market potential, identifying supply chain advantages, and utilising institutional policies to facilitate access to markets.[18] While there are opportunities for Hong Kong to capture the value, it is important to note that other cities are similarly capable. The challenge is preventing firms and people from leaving and finding ways to attract talent.

One route to development is through innovation. This may be accomplished through technological schemes, entrepreneurial support, and sponsorships that allow opportunities for business ideas to grow. It may also be in the form of more relaxed rules to allow room for creativity. For example, less monitoring of employees will allow more flexibility and freedom to brainstorm and execute ideas, allowing space for creativity and innovation to develop. The Association of Chartered Certified Accountants (ACCA) Hong Kong also supports the concept of relaxed rules for easing the entry of global talent (who plan to seize opportunities in the GBA but prefer to live in Hong Kong). This should be through faster processing of employment visas, the accelerated establishment of international schools and government subsidies to encourage the relocation of global talents to Hong Kong.

Additionally, Hong Kong can learn from other countries where economic growth is fostered by deep regional economic integration. An example is how Singapore thrives as a major beneficiary of ASEAN integration by maintaining its competitive edge by constantly developing its strengths in finance, manufacturing, and life sciences.[19] Skilling and Low (2021) highlight the importance of maintaining distinctiveness by upgrading Hong Kong's competitive advantages and strengths and emphasising the need to view integration and distinctiveness as complementary rather than competing goals.[20]

At the same time, as mentioned earlier, Hong Kong has to deepen its economic integration with the GBA, as it is evident that this is where the territory's economic future lies. To remain competitive, Hong Kong needs to maintain a dual economic identity (a distinctive international city and an integral part of the Mainland) to fulfil its role as a gateway for the world into China.

15 Skilling, D. and Low, D., 'Hong Kong & The Greater Bay Area: Integration & Distinctiveness', *HKUST Institute for Emerging Market Studies (IEMS) Research Program on the Greater Bay Area*, June 2021 (https://iems.ust.hk/publications/reports/hong-kong-the-greater-bay-area-integration-distinctiveness-by-david-skilling-and-donald-low).

16 Castagnone, M. and Yiu, E., 'Hong Kong is the gateway to business opportunities in the Greater Bay Area, financial leaders say', *South China Morning Post*, 31 October 2022 (https://www.scmp.com/business/banking-finance/article/3197805/hong-kong-gateway-business-opportunities-greater-bay-area-say-financial-leaders)

17 Kalra, A. S., 'Things employers should know about the Guangdong-Hong Kong-Macao Greater Bay Area', *humanresourcesonline.net*, 15 June 2022 (https://www.humanresourcesonline.net/things-employers-should-know-about-the-guangdong-hong-kong-macao-greater-bay-area-gba)

18 Ibid.

19 Skilling, D. and Low, D., 'Hong Kong & The Greater Bay Area: Integration & Distinctiveness', p. 9

20 Ibid, p. 7

Thus, it is only logical for company secretaries/governance professionals in Hong Kong to keep up with the latest business developments and local government policies in several key Chinese cities in the GBA. And yet, it is well known that the business norms and practices in Hong Kong and other GBA cities on the Mainland are in many aspects different. In effect, the company secretary/governance professional in Hong Kong must navigate between two different business cultures. The skills, emotional intelligence, and in-depth appreciation of the subtle cultural differences should not be overlooked, requiring mental dexterity and diplomatic skills at times to bridge the differences and bring about positive outcomes for the board and shareholders. This added value that the role brings the board often goes unacknowledged by the wider business community.

1.3 Section conclusion

Hong Kong has a significant role in the GBA by assisting companies in developing better corporate governance practices that consider both local conditions and international standards. Companies need to understand these needs to better capitalise on GBA opportunities. Mainland enterprises that aim to expand internationally and engage in foreign investment and trade must comply with the relevant regulations and requirements to ensure that their business operations run smoothly. Adhering to international standards will help companies listed in Hong Kong obtain funding from international markets.

Finally, although the GBA initiative provides enormous opportunities for economic growth, the benefits can be maximised when the accompanying risks are minimised and appropriate policies and controls are in place. Hong Kong must maintain its distinctiveness while capturing the synergies present in the GBA. It must strengthen its strategic position as an international financial centre and leverage its competitive advantages whilst being mindful of the potential risk of losing its distinctiveness, uniqueness, firms and human capital to other cities in the GBA.

HIGHLIGHTS AND TAKEAWAYS:

Hong Kong plays a significant role in developing the Greater Bay Area by raising corporate governance standards and capital funding.

In turn, Hong Kong can obtain opportunities for economic growth by enlarging its domestic market through closer integration with the GBA.

To obtain funding from international markets, listed companies must adhere to international corporate governance standards, norms, and practices.

Hong Kong should still maintain its distinctiveness and must set up policies to manage accompanying risks if it wants to maximise the growth opportunities in the GBA fully.

Company secretaries/governance professionals in Hong Kong must keep up-to-date with global economic, regulatory, and socio-political changes while deepening their business connections across the border to be 'in the loop' with what is happening in key GBA cities. Similarly, the skillset of appreciation of the subtle cultural differences should not be overlooked. This will necessitate developing a combination of technical, commercial and social skills.

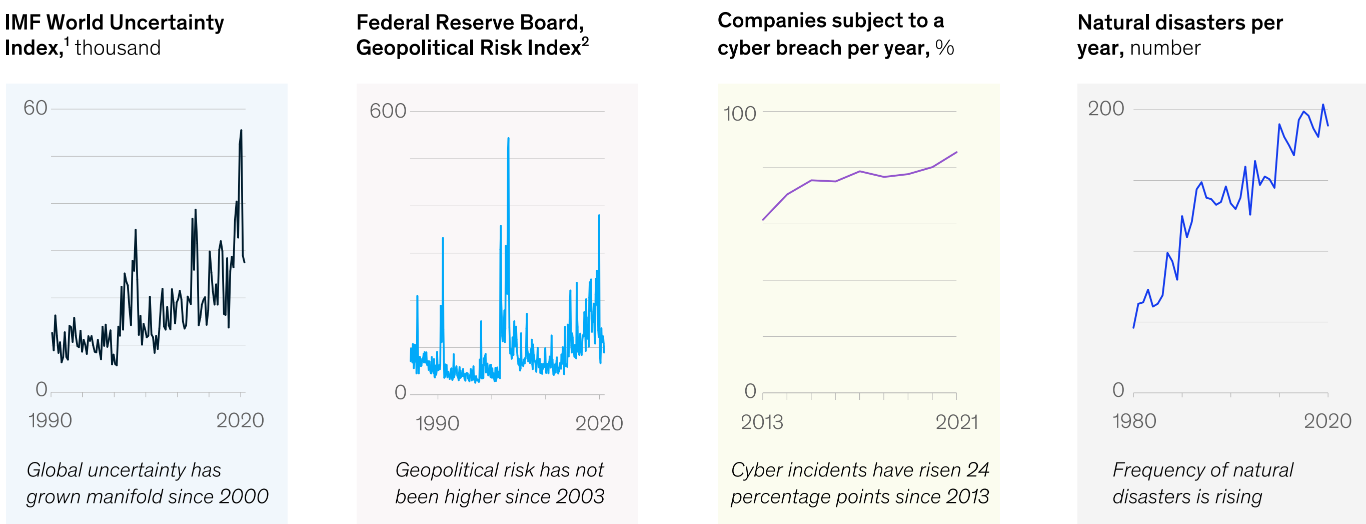
Section 2:

The COVID-19 Pandemic and Corporate Resilience

In an increasingly volatile world, resilience has never been more vital in corporate performance.[21] The COVID-19 pandemic is undeniably one of the biggest global economic shocks that tested companies' strength, if not the biggest. Many firms found themselves unprepared for disruptive events that have the potential to radically change the way business is conducted. To curb its spread, governments and organisations ordered establishments and businesses to close their offices temporarily. The pandemic has put resilience and risk management at the forefront. Martin Hirt, global co-leader of McKinsey's Strategy & Corporate Finance Practice, defines resilience as 'a company's ability to weather a crisis well' – the preparedness to handle an unforeseen event. In this sense, resilience prepares for and manages unexpected and predictable events. It is being able to prepare for the predictable, withstand the unpredictable, change what is needed and emerge stronger. For years, companies have focused on ensuring financial reserves withstand disruptions. However, it is forecasted that disruptive events could become more frequent and more severe but less predictable when placed alongside existing problems such as climate change, digital and technological revolution, and geopolitical uncertainty. Climate change concerns constantly push companies to evaluate their risk-return profiles, often following pressure from various stakeholders. The digital revolution presents a transformational promise of faster decision-making and potential large-scale failure. In an interconnected world, geopolitical risks can threaten global systems. Companies need to transcend short-termism and address scenarios from a holistic view. They must stand firm in the face of change and reinvent themselves, if necessary. In short, *resilience is a must, not a luxury*.

2.1 Organisational views on resilience and the need for a broad-based approach

Figure 1. Disruption is becoming more frequent and more severe



[1]Based on the percentage of the word "uncertain" (or its variant) in the Economist Intelligence Unit country reports.
[2]Automated text-search results from the electronic archives of 11 newspapers: *Boston Globe*, *Chicago Tribune*, *Daily Telegraph*, *Financial Times*, *Globe and Mail*, *Guardian*, *Los Angeles Times*, *New York Times*, *Times*, *Wall Street Journal*, and *Washington Post*. Index was calculated by counting the number of articles related to geopolitical risk in each newspaper for each month (as a share of the total number of news articles).
Source: CyberEdge; Swiss Re

McKinsey & Company

21 Unless otherwise stated, this section is based on Natale, A., Poppensieker, T., & Thu, M., 'From risk management to strategic resilience', McKinsey & Company, 9 March 2022 (https://www.mckinsey.com/capabilities/risk-and-resilience/our-insights/from-risk-management-to-strategic-resilience); Hirt, M., Lund, F., & Orr, G., 'The role of boards in fostering resilience', *Inside the Strategy Room* podcast, McKinsey & Company, 9 June 2021 (https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/the-role-of-boards-in-fostering-resilience); Nauck, F., Pancaldi, L., Poppensieker, T., & White, O., 'The resilience imperative: Succeeding in uncertain times', McKinsey & Company, 17 May 2021 (https://www.mckinsey.com/capabilities/risk-and-resilience/our-insights/the-resilience-imperative-succeeding-in-uncertain-times); Huber, C., Lund, F., & Spielmann, N., 'How boards have risen to the COVID-19 challenge, and what's next', McKinsey & Company, 29 April 2021 (https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/how-boards-have-risen-to-the-covid-19-challenge-and-whats-next)

In assessing how firms perceive resilience in their organisation, a survey conducted by the Federation of European Risk Management Associations (FERMA) drew responses from over 200 senior executives and professionals. It revealed a narrow risk management focus, in which financial risks were primarily the focal point. Results showed that about 60% of the respondents rated their organisation's resilience capabilities as excellent. Resilience management is embedded in their long-term strategy and development, serving as their compass in navigating a more dynamic business environment. Most respondents considered the pandemic a turning point in making resilience a priority in their organisations, as it widened their view on risk management. On the other hand, however, while recognising the importance of operational, digital and technological resilience and the need to improve foresight capabilities in scenarios and stress testing, 52% said that the most effective capabilities in their organisation were for managing *financial resilience.*

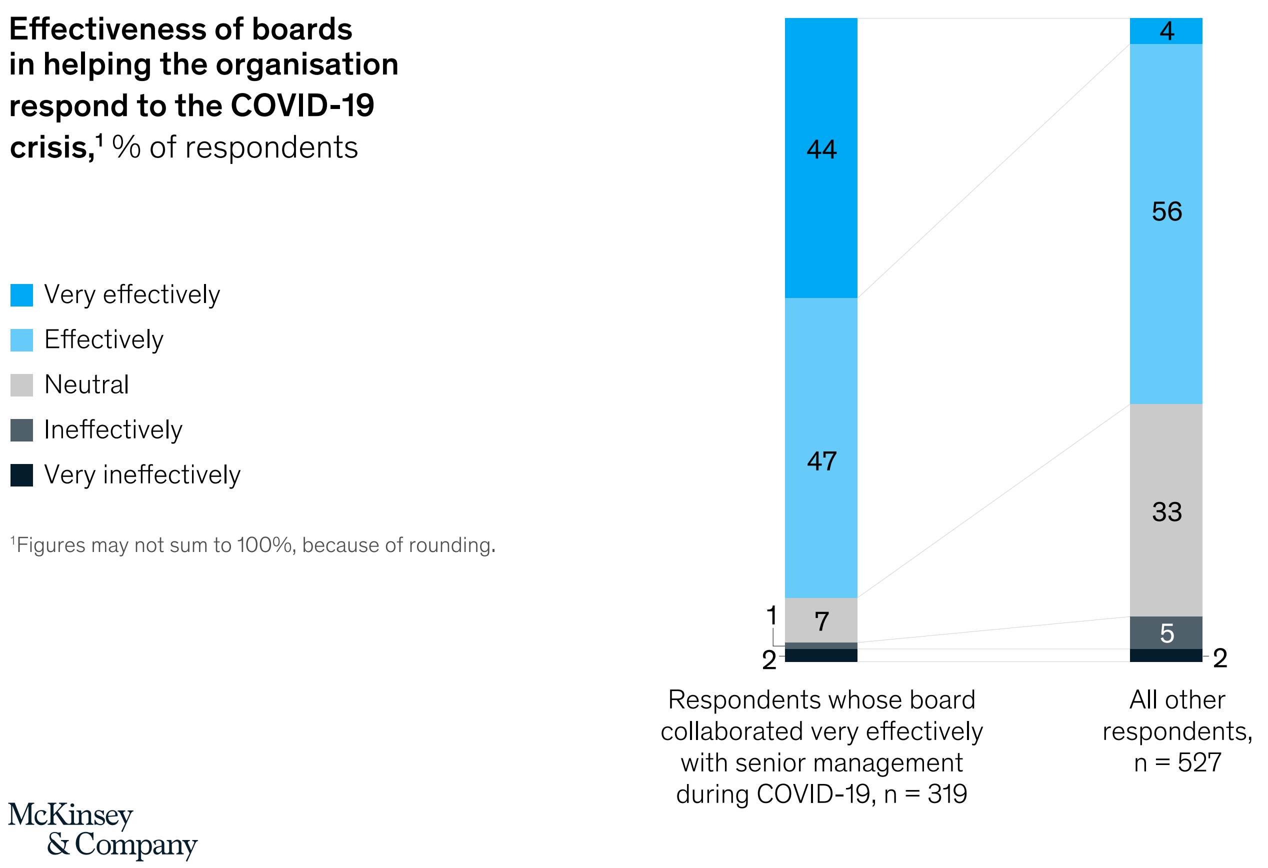
Financial resilience should not be the only focus if companies are to meet changing circumstances successfully. A broader view of resilience is needed to drive change internally, focusing more broadly on operations, technology, organisation, reputation and the business model. Companies must strengthen their supply chains and delivery mechanisms in providing customers goods and services to remain stable during operational disruptions. Investment in robust, secure and flexible infrastructure is needed to foster technological resilience. A culture where excellence, diversity in the workforce, inclusion, and adherence to rules and standards are valued strengthens organisational resilience. Institutions that demonstrate accountability and openness when communicating with stakeholders display good reputational resilience in anticipating, addressing and meeting societal expectations. Finally, resilient organisations value entrepreneurship and innovation by evolving their business models to adapt to shifts in customer demand, competition, and technological and regulatory changes. Firms that place equal emphasis across these dimensions and harness their capabilities tend to be more resilient and, as a result, respond to disruptions more effectively.

While the pandemic showed the hidden vulnerabilities and weaknesses in organisational response capabilities, we saw some excellent examples of resilient responses to the challenges. Many companies utilise digital solutions and advanced analytics to address supply chain issues. While working online from home exposed companies to the risk of cyber-attacks, many demonstrated organisational resilience by extending their security shield to remote endpoints in employees' homes. In addition, a few firms have tried to prepare for the next disruption by adopting a comprehensive strategic perspective. The challenges of the pandemic served as a lesson for companies to appreciate the importance of resilience, evaluate their resilience capability, anticipate future needs and strengthen these. Therefore, successful companies are learning to embed resilience management within their strategy.

2.2 Resilience in the boards' corporate agenda

In moving towards recovery from the pandemic, companies are paying closer attention to the role of corporate governance and the board in managing crises. In the face of external shocks, the board of directors is crucial in strengthening company resilience.[22] A Global Survey of more than 800 directors and executives showed that boards had to rise quickly to the challenge of managing a global public health and economic crisis, despite the toll it took on their overall corporate performance. Boards of successful companies adopted new and improved ways to operate, updated their structures and processes, became more flexible in their agenda setting, focused on corporate resilience, and devoted more time to board-related work. The survey also revealed that the collaboration between the board and the management significantly improved, which was crucial in ensuring the effectiveness of the company's response to the crisis. 79% of the respondents considered this collaboration to have been very effective in supporting a better pandemic response (Figure 3). More than 90% of them viewed their board's response to the crisis as effective.

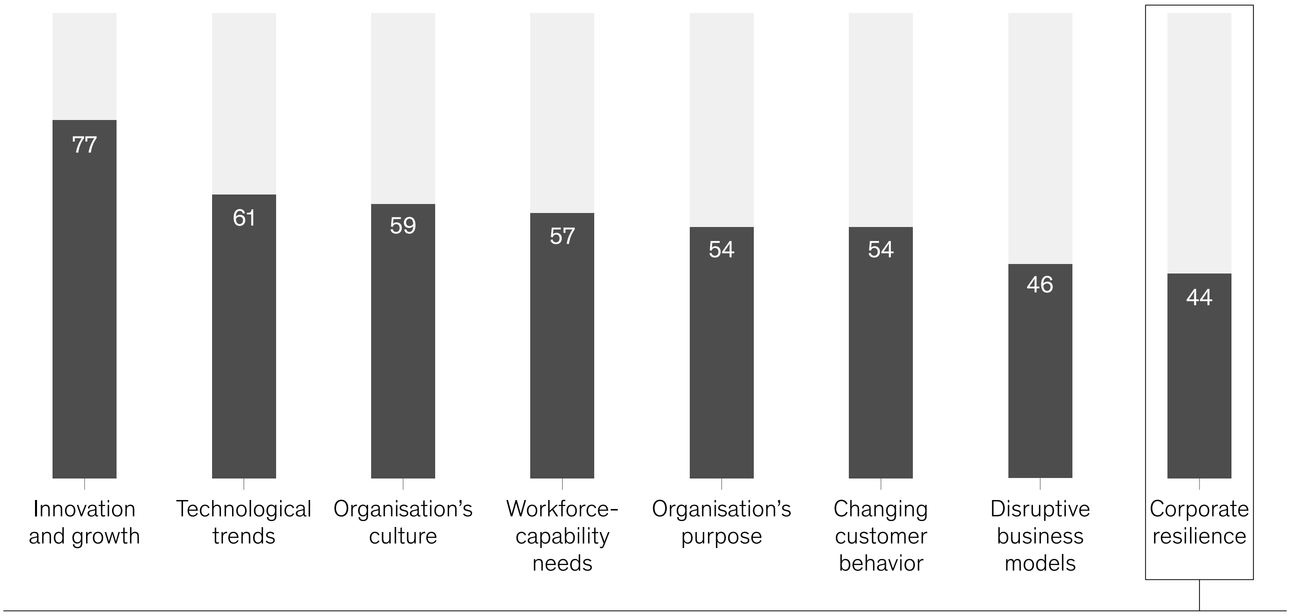
Figure 2. Better collaboration between boards and management teams seems to have supported a more effective COVID-19 response



The pandemic experience changed the way resilience is viewed in the corporate agenda. Boards have elevated the task of ensuring resilience on the board's agenda (Figure 3), which suggests an increased focus on its importance (Figure 4). The lockdowns led to changes in the dynamics between the executive and non-executive teams in pursuit of the common goal of ensuring the company's and its stakeholders' well-being. These developments highlight the board's role in fostering resilience in the organisation and steering it toward recovery.

22 HKEX, 'Chapter 5 Directors, Company Secretary, Board Committees, Authorised Representatives and Corporate Governance Matters', *Rules and Guidance* (https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Other-Resources/Continuing-Obligations-and-Annual-Listing-Fees/Continuing-Obligation-Fee/chapter_5.pdf?la=en)

Topics on the board's 2019 agenda,[1] % of respondents

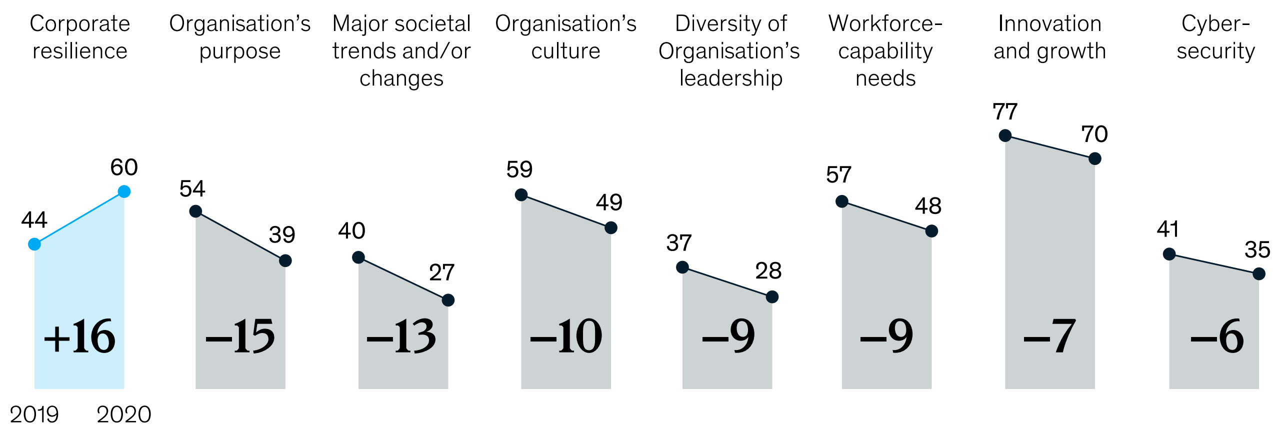


How prepared boards were in 2019 to manage a lack of corporate resilience within their organisations,[2] % of respondents

[1]Out of 15 agenda topics that were offered as answer choices.
[2]Question was asked only of respondents who identified "lack of corporate resilience" as a significant challenge that their organisations were facing; it was cited by 22%. Respondents who answered "don't know/not applicable" are not shown, so figures do not sum to 100%.

Figure 3. In 2019, corporate resilience ranked low on the board agenda - and for boards that saw it as a challenge, few were prepared to manage it

Topics on the board's current agenda,[1] % of respondents



[1]Out of 15 topics that were offered as answer choices. 2019, n = 1,041; 2020, n = 846.

Figure 4. Compared with 2019, respondents report a clear shift in the topics on their boards' agendas

2.3 How the pandemic challenged and prompted the rewriting of the rules of corporate governance

While a few companies have shown excellent adaptability and resilience since the onset of the pandemic, dealing with challenges has not been easy for all boards. For example, the pandemic raised serious questions about dividend policy. Large U.S. banks generally chose to maintain the dividend, whilst those in Europe mostly followed the guidance of policymakers urging cuts. These decisions necessitated board discussions and effective communication with shareholders and other stakeholders. Thus, the pandemic rekindled the debate about the balance between shareholder interests and the demands from various stakeholder groups and increased expectations for corporate citizenship and societal engagement. This may result in rewriting corporate governance rules and shifting away from shareholder-centric structures and considerations.[23]

Moving forward, company boards may have to reassess key areas of corporate governance. First, they may have to pay greater attention to stakeholders. The crisis demonstrated how much society depends on well-functioning companies to provide for basic needs. But for a company to function well, relationships and commitments to all stakeholder groups – shareholders, employees, customers, suppliers, and communities – must be maintained. This calls for boards to take a more active role in monitoring these relationships, which may involve better reporting on the status of stakeholder groups, a more precise definition of the company's responsibilities towards each group, setting goals on commitments, and tracking the company's relationship with stakeholders over time.

Second, there are calls for companies to pay more attention to how business and society intersect. For years, companies have been urged to assist in addressing problems such as income and wealth inequality, racial and gender discrimination, public health and education, corruption, and climate change, to name a few. However, these were often regarded as being outside the concerns of business executives in fulfilling their fiduciary duties to shareholders. The pandemic has shown that societal forces have the potential to affect businesses as much as market forces do. Company leaders should strengthen their risk management systems to cover these large-scale societal forces.

Third, the traditional pay-for-performance paradigm raises questions about equity and fairness, as 'performance' was mostly defined in relation to shareholder returns, and pay was considered a motivational tool for executives to maximise those returns. This resulted in a flawed compensation system that often disregarded other performance indicators. A few boards have heeded the call to include additional performance metrics related to the company's strategy, social impact, and environmental impact, with more recent ones on reductions in carbon emissions and measures of diversity and inclusion. The new framework places additional burdens on boards to ensure that compensation programs align with the company's strategy and societal commitments.

Lastly, there is a need for more attention to board procedures and diversity. The pandemic highlighted the importance of hearing different perspectives and weighing multiple options. Boards were confronted with novel issues to which they had no precedent to refer. Boards that had already adopted policies on virtual shareholder meetings were quicker to adapt and emerged more resilient. The need to be able to explore more alternatives arose just as quickly. The board's job is to provide strategic guidance to meet the company's needs. This necessitates a diverse set of skills, experience and perspectives to be present in the boardroom for the board to fulfil its role well. Having to deliver for all stakeholders while facing the impact of the pandemic made it even more imperative for boards to establish teams where varied perspectives could be shared. Going forward, boards will have to place even more emphasis on reviewing succession plans, keeping in mind the need for diversity in race, gender, ethnicity, geography, domain expertise and industry in a manner consistent with corporate strategy. This can be done by developing new channels to identify talents and approaches for onboarding directors to achieve a truly diverse board.

23 Based on Paine, L., 'Covid-19 Is Rewriting the Rules of Corporate Governance', Harvard Business Review, 06 October 2020 (https://hbr.org/2020/10/covid-19-is-rewriting-the-rules-of-corporate-governance?registration=success)

Company secretaries/governance professionals in Hong Kong should seek to enhance their facilitation of stakeholder communication inside and outside their organisations as an essential step to good governance in line with international developments. However, there is a need to be culturally sensitive to the distinctive characteristics of a dual economic identity between Hong Kong and the Mainland that has been the winning formula for much of the territory's economic growth. As such, bridging key stakeholders and communicating their interests with the board shall be an important and essential new function. Importantly, if the listed entity's main business operations and headquarters are across the border, granting the company secretary/governance professional access to resources, information, and key personnel similar to a senior executive on the Mainland will be essential. Otherwise, gaps in the company's governance could manifest from misunderstandings in the regulatory expectations of the HKEX if the entity is listed in Hong Kong.

2.4 Section conclusion

The pandemic expedited changes that may have taken longer to develop otherwise. It has also highlighted the need for resilience in corporate strategy and governance. Resilience necessitates that boards consider shareholders' interests and all stakeholders. The pandemic demonstrated that resilience, or a lack thereof, is a key factor behind why companies thrive or fail and the importance of incorporating it in their strategy, operations, and corporate governance. It has become imperative for resilience to be institutionalised and embedded in good governance to build up the company's adaptive capacity and emerge victorious in the face of threats.

HIGHLIGHTS AND TAKEAWAYS:

The COVID-19 pandemic tested companies' corporate resilience, induced them to reflect on their resilience capabilities and focus, and changed how resilience is now viewed regarding its importance and relevance as a corporate agenda.

The pandemic revealed the board's role in building the company's resilience and the need for a broad-based approach and a strong collaboration with the management to foster resilience in the organisation.

The pandemic experience also prompted the rules of corporate governance to be rewritten and unveiled key areas that the boards will have to reassess moving forward. For example, a shift in relationship management focuses from shareholders to wider stakeholder groups, more attention to the broader intersection between business and society, compensation and payment for performance, and board structure and diversity.

Company secretaries/governance professionals in Hong Kong engaging stakeholders inside and outside the company is an essential step to developing a stakeholder's approach to good governance. However, this cannot be at the expense of the current distinctive characteristics of a dual economic identity that has been the winning formula for much of the territory's economic growth. Importantly, if the listed entity's main business operations and headquarters are across the border, granting the company secretary/governance professional access to resources, information, and key personnel similar to a senior executive on the Mainland will be essential. Otherwise, gaps in the company's governance could manifest from misunderstandings in the regulatory expectations of the HKEX if the entity is listed in Hong Kong.

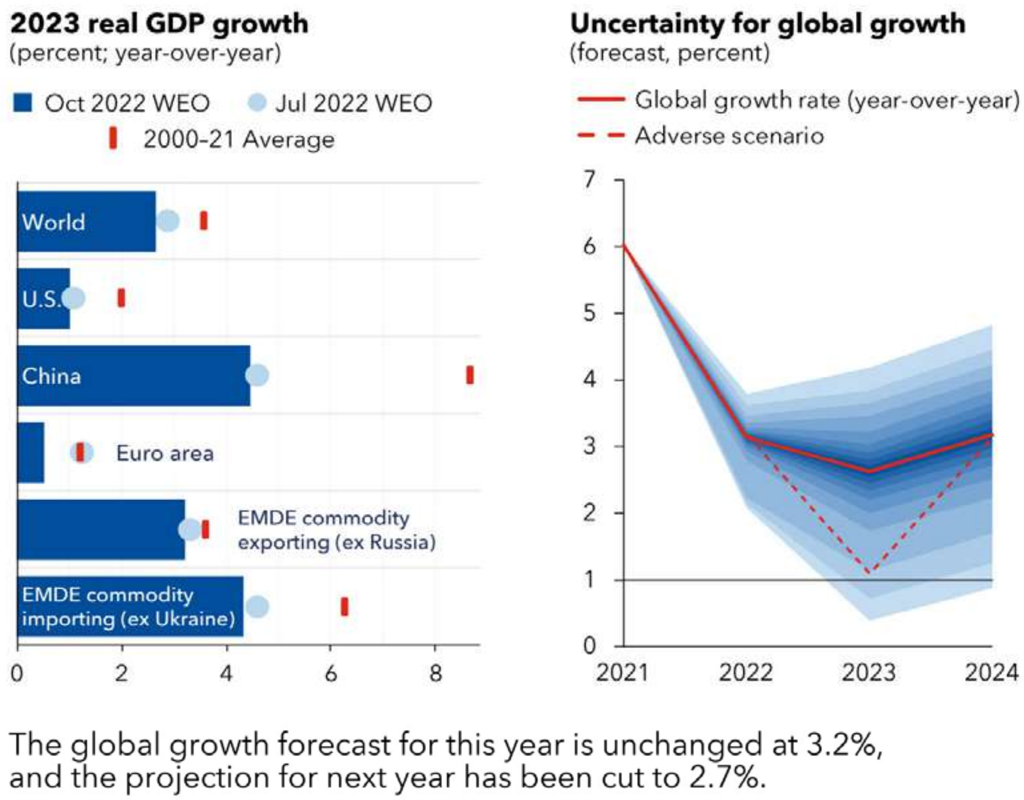
Section 3:

Broader Challenges in Corporate Governance

In this section, we examine how key macro level (geopolitical tensions such as the Russian invasion of Ukraine and a possible global economic recession). Also, the micro-level challenges (operations, labour and human resources, and innovation) could substantially impact how corporations are governed.

3.1 Macro challenges brought by global events

Figure 5. Global growth forecast (2021-2024)



Sources: IMF, World Economic Outlook; and IMF staff calculations.
Note: Right panel fan shades denote 5-95 percentile; black line represents stagnant global income per capita.

In addition to the risks posed by the pandemic, firms face macroeconomic challenges arising from geopolitical tensions, supply chain disruptions, the effects of the Russian invasion of Ukraine (particularly on food and energy prices), and the risks of stagflation and recession. The World Economic Forum's 2022 Global Risk Report identifies labour market gaps, more significant mobility barriers, increased competition in space, and operational challenges resulting from foreign economic trends as additional risks.[24] The International Monetary Fund warns that 2023 'will feel like a recession' for many people, with global growth forecasted to drop from 3.2% in 2022 to 2.7% in 2023 (Figure 5), reflecting significant slowdowns in large economies.[25] Although the pandemic has slowed down and gradually moderated in most countries, it continues to disrupt economic activity, particularly in China.[26] These challenges impact Hong Kong as well.

24 Peregrine, M., 'The Globalization of Corporate Governance'

25 International Monetary Fund, 'Policymakers Need Steady Hand as Storm Clouds Gather Over Global Economy', *IMF Blog*, 11 October 2022 (https://www.imf.org/en/Blogs/Articles/2022/10/11/policymakers-need-steady-hand-as-storm-clouds-gather-over-global-economy)

26 International Monetary Fund, 'World Economic Outlook: Countering the Cost-of-Living Crisis', October 2022 (https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022)

The war in Ukraine has increased geopolitical risks and uncertainty, leading to increased commodity prices, rising inflation, and tighter financial conditions.[27] The UN Global Crisis Response Group on Food, Energy and Finance highlighted that more people are at risk of food insecurity and extreme poverty as they grapple with high commodity prices and the intensifying cost-of-living crisis.[28] The production of food and agricultural products is threatened, which may worsen malnourishment and health problems. The war has disrupted the supply of fossil fuels, increasing price levels and price volatility since Russia had been the leading natural gas exporter and the second-largest oil exporter worldwide. Developing countries face incredible difficulty as these crises increase social and fiscal pressures. Adding to these problems are growing fears of a potential return to stagflation, which will reduce household incomes, strain budgetary space, and cause the cost of living to accelerate.

3.2 The impact of the Ukraine war on Hong Kong

A study by Haitong International Securities Group explored the impact of the war in Ukraine (and the resulting sanctions on Russia) on the Hong Kong economy and financial markets and identified specific areas where the crisis directly or indirectly has had an impact.[29] Their analysis shows that the direct impact of the war on Hong Kong is limited. The foreign exchange market has remained stable since the Hong Kong dollar has not reached the lower bound of its range, despite a continued downward trend against the US dollar over the past year (Figure 6). Furthermore, the impact on energy and agricultural product supply has been moderated due to low dependence on Russia and Ukraine. Regarding inflation, Hong Kong's small distances and sophisticated public transport system lead to low energy needs, and commuting cost

Figure 6. Changes in the price of major financial assets and liquidity indicators in Hong Kong since the Ukraine crisis broke out

	Feb 24, 2022	Mar 25, 2022	Accumulated changes	Largest pullback by
Hang Seng Index	23660	21405	-9.5%	-22.9%
Hang Seng China Enterprises Index	8317	7284	-12.4%	-27.2%
Hang Seng IT Index	5299	4379	-17.4%	-34.5%
Chinese USD-denominated bonds: investment grade index	211.3	203.8	-3.6%	-4.3%
Chinese USD-denominated bonds: high yield index	246.2	190	-21.2%	-29.5%
Exchange rate of HKD against USD	7.8049	7.8284	-0.3%	-0.34%
The closing aggregate balance of the HK interbank market	339.1 billion HKD	337.5 billion HKD	-0.5%	-0.5%

Sources: CEIC; Bloomberg; Haitong International; CF40

27 Caldara, D., Conlisk, S., Iacoviello, M. and Penn, M., 'The Effect of the War in Ukraine on Global Activity and Inflation', *FEDS Notes*, 27 May 2022 (https://www.federalreserve.gov/econres/notes/feds-notes/the-effect-of-the-war-in-ukraine-on-global-activity-and-inflation-20220527.html)

28 UN Global Crisis Response Group on Food, Energy and Finance, 'Global impact of war in Ukraine: Energy crisis', *United Nations*, August 2022 (https://news.un.org/pages/wp-content/uploads/2022/08/GCRG_3rd-Brief_Aug3_2022_FINAL.pdf)

29 This sub-section draws on Mingchun, S., Yixuan, Y., and Jing, L., 'The Ukraine Crisis: Impacts on the Hong Kong Economy and Financial Market', *CF40*, 25 April 2022 (http://new.cf40.org.cn/uploads/newsletter/20220425smc.pdf)

contributes only 6.2% to the Consumer Price Index (CPI) (compared to 16% in the US). Finally, the food CPI is influenced mainly by store rents and service prices rather than the price of food staples such as grain. Therefore, the worldwide food and energy price hikes resulting from the war may have had a relatively minor impact on Hong Kong.

The indirect impact of the war arises from its status as a global financial hub and its exposure to global economic growth, inflation, financial stability and geopolitics. For instance, inflation has forced Western central banks to tighten monetary policies. The U.S. Fed's interest rate hike threatens Hong Kong's financial stability due to added risks of a liquidity crunch. Due to the peg between Hong Kong and U.S. dollars, Hong Kong effectively 'imports' U.S. monetary policy. The Fed's tightening and rate hikes resulted in liquidity contraction in Hong Kong, which impacted the local real estate market and banking system. Bond issuers in Hong Kong also face more significant uncertainties and risks from more expensive financing.

Historical data suggests that liquidity tightening and interest rate hikes may not adversely affect Hong Kong stocks as they pressure companies to maintain good corporate earnings. Furthermore, since about half of Hong Kong's market capitalisation comprises the value of Mainland Chinese companies, it may be impacted more by the war's impact on the Chinese economy than the Fed's monetary policy. In the short term, the disruption of global supply chains may affect China's domestic economic activity and international trade. In contrast, in the long term, de-coupling and a hostile geopolitical environment could hamper China's long-term development strategies, such as the Belt and Road Initiatives and dual circulation. As Hong Kong serves as the gateway to the Mainland and relies heavily on its economy and market, it is indirectly impacted by the Ukraine war and other geopolitical challenges through their direct impacts on the Mainland.

Therefore, company secretaries/governance professionals should include present and future wars in short to long-term risk analysis as this is critical to assist boards in managing such risks. And, given that the territory is a small open economy, future economic shocks and new geopolitical tensions could erupt in any part of the world, impacting the equity and financial markets. Therefore, business continuity plans must be developed with the board to prepare for such eventualities.

3.3 Other micro-challenges

In addition to grappling with external challenges arising from global events, companies also struggle with internal issues, particularly in human resources, entrepreneurship, innovation, and profit maintenance. SWBC executive Mandy Smith highlights the four significant challenges employers faced in 2022:

- Talent attraction and retention
- Preserving company culture under the new work arrangements prompted by the COVID-19 pandemic
- Upskilling and reskilling employees
- Reducing internal compliance and data security risks[30]

30 Smith, M., '4 Major Challenges Employers Are Facing in 2022', *SWBC Blog*, 13 July 2022 (https://blog.swbc.com/businesshub/4-major-challenges-employers-are-facing-in-2022)

Inflation at a time of lower growth may have implications for nominal wage pressures on companies. IMF analysis shows a correlation between inflation expectations, labour market slack, and nominal wages. High inflationary expectations are positively related to nominal wage growth, while higher labour market slack correlates with a wage growth slowdown.[31] Advanced economies appear more sensitive to inflationary expectations compared to emerging markets. A one percentage point increase in inflationary expectations is associated with a one percentage point wage increase.

Other trends have created labour shortages and wage pressures in specific sectors. According to a survey conducted by Wills Towers Watson, Hong Kong companies that cannot afford the higher costs or anticipate a recession are three times more likely to reduce employment than wages.[32] The job cuts are more pronounced in the banking industry, mainly due to reduced underwriting and advisory activities. While banks see great potential in China overall, the uncertain outlook has prompted them to hire or relocate staff across the Asia-Pacific region and expand their coverage in places such as Singapore, South East Asia and India, hoping to widen an offering that was previously narrowly focused on Hong Kong.[33] However, this approach is not without costs. For example, many companies that responded by cutting staff early in the pandemic experienced severe labour shortages when the pandemic eased, and economic activity picked up. An example is the chaos in several European airports in the summer of 2022 due to staff shortages. Remote or hybrid work has driven high turnover in the labour market as employees seek more flexibility.[34] Some college students and recent graduates have considered pursuing advanced degrees instead of getting a job right away to wait out economic shocks.[35] Companies face difficulties in hiring staff with the right skills, especially during increased uncertainty, rapid technological changes, and increased requirements for regulatory compliance. As a result, many companies have had to raise wages and upgrade their benefits and work conditions to keep existing employees from leaving and to attract more talent.[36]

Another challenge impacting labour costs is monitoring employee performance when work arrangements are more varied, and employees have more flexibility. Home conditions, childcare responsibilities, stress and mental health challenges may contribute to low productivity levels, forcing companies to think of ways to offer support when both sides are working remotely.

Technological innovation produces new challenges. McKinsey predicts a possible diversion in global technology standards among countries. This could result in restricted content services, selective promotion of favoured technology standards, new internet protocols, and tighter laws on telecommunications and cybersecurity.[37]

Cybersecurity has also developed into an area of increased concern due to emerging threats. 81% of the 2,900 IT decision-makers surveyed in the Equinix 2022 Global Tech Trends Survey agree that improving cybersecurity is crucial.[38] While 76% claim that cost-cutting is critical, 72% emphasise that data protection regulations and compliance must be in place to improve customer experience. In an increasingly digitalised world, companies are constantly challenged to find suitable digital models that would function, even more so at a time of increasing volatility.

The micro-challenges mentioned could pose a risk for companies in Hong Kong and the GBA. Even if those risks might not happen simultaneously, each issue does matter. Again, being prepared with business continuity plans in place is indispensable.

31 International Monetary Fund, 'World Economic Outlook: Countering the Cost-of-Living Crisis', October 2022 (https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022)

32 Punay, N., 'Pay cuts, salary stagnation await workers in post-pandemic workplace', *Hong Kong Business*, 2021 (https://hongkongbusiness.hk/hr-education/in-focus/pay-cuts-salary-stagnation-await-workers-in-post-pandemic-workplace-0)

33 Rothnie, D., 'Why the banking job cuts are worse in Hong Kong', *Efinancialcareers*, 02 September 2022 (https://www.efinancialcareers.hk/news/2022/09/hong-kong-banking-job-cuts)

34 Liu, J., 'Remote work could keep fueling high turnover: 'The map is open for job seekers', *CNBC*, 07 October 2022 (https://www.cnbc.com/2022/10/07/remote-work-could-keep-fueling-high-turnover.html)

35 Liu, J., '86% of Gen Z interns think a recession is coming – and it's changing their approach to their careers', 12 October 2022 (https://www.cnbc.com/2022/10/12/goldman-sachs-intern-survey-shows-gen-z-recession-fears-career-priorities.html)

36 Liu, J., 'CEOs are preparing for a recession. Their plans could backfire', *CNBC*, 20 October 2022 (https://www.cnbc.com/amp/2022/10/20/ceos-plan-for-recession-with-staff-esg-cuts-it-could-backfire.html?__source=instagram%7Cmain)

37 White, O. et al., 'War in Ukraine: Twelve disruptions changing the world', *McKinsey & Company*, 09 May 2022 (https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/war-in-ukraine-twelve-disruptions-changing-the-world#0)

38 Equinix, 'Seven in 10 Hong Kong Businesses Plan to Expand in New Markets in the Next 12 Months', 06 July 2022 (https://www.equinix.hk/newsroom/press-releases/2022/07/seven-in-10-hong-kong-businesses-plan-to-expand-in-new-markets-in-the-next-12-months)

3.4 The impact on corporate governance in Hong Kong

These macro and micro challenges significantly affect corporate governance (short or long term), as new risks may prompt regulators, financial institutions and companies to rethink their approaches. The SAR government is set to implement new initiatives to support companies facing new challenges, as outlined in the policy address delivered by the new Hong Kong SAR's Chief Executive, The Hon John Lee Ka-chiu GBM SBS PDSM PMSM. Some of these are aimed at attracting new talent and investment, grooming local talent, improving labour rights and occupational safety, promoting diversity and inclusion, and enhancing the governance capability of the government.[39] Schemes to improve Hong Kong's competitiveness will be put in place, such as the Office for Attracting Strategic Enterprises (OASES), which aims to attract talent from the Mainland and overseas, especially in industries of strategic importance such as healthcare, Fintech, AI/data science, and green energy technology. Youth development programmes, internships and subsidies are planned to encourage young people to study and work in Hong Kong, while support is on the way to SMEs to help their businesses. For example, more GoGBA Business Support Centres are being planned by the Hong Kong Trade Development Council to cover all nine Mainland cities in the Greater Bay Area to assist companies when they expand there. In terms of labour rights, occupational safety, and empowerment of women and ethnic minorities, policies and procedures will be enhanced, and investigations on industrial accidents will be stricter to ensure accountability.

In the future, it is expected that the new macroeconomic challenges will usher global trends that will further influence the rules on governance in Hong Kong. Good corporate governance is a dynamic process. Global trends in corporate governance include assertive investors who demand greater transparency and require companies to demonstrate their contribution in preparing to respond to global problems,[40] better communication with shareholders and other stakeholders and channels for them to express their views, better evaluation of the implementation and effectiveness of these policies, and new channels for the delivery of independent views to the board. What were once non-compulsory items for disclosure might become mandatory, with the stricter assessment of the validity of the reasons behind deviations. In addition, the revised Corporate Governance Code took effect on 1 January 2022.[41] It is divided into two parts. Part 1 sets out the mandatory disclosure requirements. Recognising that a one-size-fits-all approach may not be appropriate, Part 2 lays out the principles of good corporate governance, code provisions, and recommended best practices that serve as a guide rather than a mandatory requirement.[42] However, the Code considers non-compliance to either Part 1 or Part 2, without a statement of 'Considered Reasons and Explanations', as a breach.[43]

39 Chan, T., 'Hong Kong's 2022 Policy Address: Key takeaways business and HK leaders should know', *Human Resources Online*, 20 October 2022 (https://www.humanresourcesonline.net/hong-kong-s-2022-policy-address-key-takeaways-business-and-hr-leaders-should-know)

40 Russel Reynolds Associates, '2022 Global and Regional Trends in Corporate Governance', *ICDM Pulse*, 15 March 2022 (https://pulse.icdm.com.my/article/2022-global-and-regional-trends-in-corporate-governance/)

41 HKEX, 'Exchange Publishes Conclusions on Review of Corporate Governance Code', *HKEX – News Centre*, 10 December 2021 (https://www.hkex.com.hk/News/Regulatory-Announcements/2021/211210news?sc_lang=en)

42 HKEX, 'Appendix 14 Corporate Governance Code: Introduction', *Rules and Guidance*, January 2022 (https://en-rules.hkex.com.hk/rulebook/introduction-8)

43 Angela Wang & Co., 'New Corporate Governance Rules Affecting Hong Kong INEDs', *Angela Wang & Co Solicitors*, 11 May 2022 (https://www.angelawangco.com/en/news-updates/new-corporate-governance-rules-affecting-hong-kong-ineds/)

Boards must strengthen their oversight of how economic, social and political risks reshape the business environment. Boards should be on the lookout for future risks, such as the likely event of a global recession, assess their readiness and ability to cope, evaluate the pros and cons of their strategies, and identify potential mishaps. To illustrate, a CNBC article shares KPMG survey results showing that some U.S. CEOs anticipating a global recession respond by cutting costs, investment and ESG budgets and reducing staff as their primary preparation methods.[44] Such approaches may prove problematic, as the ways companies used to respond to previous crises may not be equally effective in dealing with future crises. For example, cutting ESG budgets may jeopardise long-term growth, as this may cause a fallout between the company and its investors, customers and employees in the long run. As governments are expected to align energy policies, and investment with the Sustainable Development Goals and the Paris Agreement,[45] related company actions may face enhanced scrutiny. In Hong Kong, reducing ESG budgets may face push-back, given Hong Kong's commitment to a sustainable green economy and dedication to upholding the highest governance standards to preserve its status as an international financial centre.

Meanwhile, by extension, companies will also have to consider external pressures from stakeholders from a corporate citizenship perspective.[46] The boards will have to assess to what extent pressures from the public, politicians and the media influence their relationships with third parties that may be directly involved in controversial issues. Boards need to pay closer attention to global trends and events, understand how they affect the organisation, and ensure that they are prepared, equipped and capable of doing what they must do to prevail.

To carry out the above tasks, the company secretary/governance professional has to do more than collect and collate information for the board. Independent assessment and analysis are indispensable. Furthermore, it requires an acute awareness of the company's broader macro and internal micro risks. Apart from the familiarity of the business, formal authority and recognition from internal and external stakeholders of the company must be conferred onto the company secretary/governance professional. This is necessary to effectively complete such tasks with access to information in the company and the board's confidence to communicate with internal and external stakeholders. These are not functions that an administrator could undertake effectively, and it calls for someone with powers similar to a senior executive.

44 Liu, J., 'CEOs are preparing for a recession. Their plans could backfire', *CNBC*, 20 October 2022 (https://www.cnbc.com/amp/2022/10/20/ceos-plan-for-recession-with-staff-esg-cuts-it-could-backfire.html?__source=instagram%7Cmain)

45 UN Global Crisis Response Group on Food, Energy and Finance, 'Global impact of war in Ukraine: Energy crisis', *United Nations*

46 Peregrine, M., 'The Globalization of Corporate Governance', *Forbes,* 13 March 2022 (https://www.forbes.com/sites/michaelperegrine/2022/03/13/the-globalization-of-corporate-governance/?sh=304fec9e57a1)

3.5 Section conclusion

Stephen Olson, Senior Research Fellow at the Hinrich Foundation, believes that 'geopolitical issues will intrude into the boardroom much more than before'.[47] Even though the sanctions imposed on Russia have no direct impact on Hong Kong, they still affect companies and individuals who do business in Hong Kong. They need to assess whether the goods they sell or the industries and stakeholders they do business with are subject to those sanctions and, if they are, which activities of those companies are affected. Thus, he suggests that companies should review their contractual arrangements with other parties and ensure that there are options or exit clauses to terminate the agreements. In dealing with macroeconomic challenges and geopolitical risks, companies have to rethink how these crises affect internal operations, such as the business model, financial operations, management and organisation, technology and innovation, and reputation – all of which would require resilience and strength. Companies should conduct scenario planning that includes what to do in case of disruptions. The less prepared companies are, the more severe these disruptions may be. Companies must devise survival plans and develop ways to work smarter to survive. Now more than ever, companies should recognise the value of other stakeholders beyond investors, such as customers and employees, in shaping the choices they have to make in response to crises.[48]

HIGHLIGHTS AND TAKEAWAYS:

Current global events such as geopolitical tensions, the Russian invasion of Ukraine, food and energy crises, and the risk of recession and stagflation, create extra challenges for companies, require them to rethink their strategies and strengthen their oversight of how economic, social and political factors may shape the business environment.

Micro challenges also affect companies' capacity to attract and retain talent, monitor employee performance, provide support, and drive innovation to stay in the market.

Geopolitical issues and global events are predicted to occupy boardroom discussions more than before. To cope, companies must have a survival plan, continuously assess their readiness capabilities, evaluate the pros and cons of their strategies, identify potential mishaps, be on the lookout for future risks, and constantly develop ways to work smarter.

Company secretaries/governance professionals in Hong Kong keeping abreast of these challenges is essential to maintaining good governance. With such knowledge, it would be natural for company secretaries/governance professionals to assist boards in managing those risks and draw up business continuity plans to deal with possible fallouts or eventualities. Boards must therefore delegate formal duties to the appropriate authority.

47 Hong Kong General Chamber of Commerce, 'Impact of Ukraine Crisis', *Chamber in Review*, June 2022 (https://www.chamber.org.hk/en/information/the-bulletin_detail.aspx?id=913)

48 White, O. et al., 'War in Ukraine: Twelve disruptions changing the world', McKinsey & Company

Section 4:

Climate Change, Carbon Emissions, and Environmental, Social, and Governance (ESG) aspects

4.1 Climate Change

Climate change is a significant challenge forcing companies and organisations to reconsider their core business operations. Climate change impacts are felt globally as they manifest in extreme temperatures and worsening calamities, from floods and super typhoons to droughts and heat waves. Weather disasters in 2022 alone have cost thousands of lives and amounted to $38.4 billion in damages globally, with $20 billion of this attributed to Hurricane Ian in the U.S. and the drought and heat wave in Europe.[49] The extreme heat wave not only claimed the lives of at least 16,000 people in Europe but also caused severe damage to land and agriculture, disrupted power plant systems, and reduced shipping on European rivers. The effects of the 2019-20 wildfires in Australia are felt up to date, as the plumes of smoke from the fires may have enlarged the hole in the ozone layer, leading to a spike in atmospheric temperatures.[50] Asia is not spared as the spring heat melted Pakistan's glaciers, and the monsoon rain swelled the nation's rivers and brought catastrophic floods that killed around 1,700 people.[51] In Hong Kong, the intense heat waves, brutal summers and typhoons are affecting the city's poor, worsening the living conditions of low-income families.[52] These are just some of the devastating effects of climate change facing the world today, which may only worsen in the coming years. The impact of climate change makes no geographical exceptions; it is global, affecting resources, food and security, disrupting global supply chains and causing inflation.

Climate risks have grown so large that procrastinating climate action will consume even more resources in the future. Recently, 20 nations at high risk from global warming are considering halting their collective debt payments to offset compensation claims related to the impact on their climate. Debt forgiveness would allow them to reinvest in conservation and alleviate the effects of climate change, as proposed by Mohamad Nasheed, the former President of Maldives, during discussions at the International Monetary Fund and World Bank meeting this year.[53] Global debt has surged with the onset of the pandemic, and according to the World Bank, 58% of the world's poorest countries are at risk of 'debt distress' following high inflation, rising interest rates and slower growth.[54]

49 Masters, J., 'World rocked by 29 billion-dollar weather disasters in 2022', *Yale Climate Connections*, 19 October 2022 (https://yaleclimateconnections.org/2022/10/world-rocked-by-29-billion-dollar-weather-disasters-in-2022/)

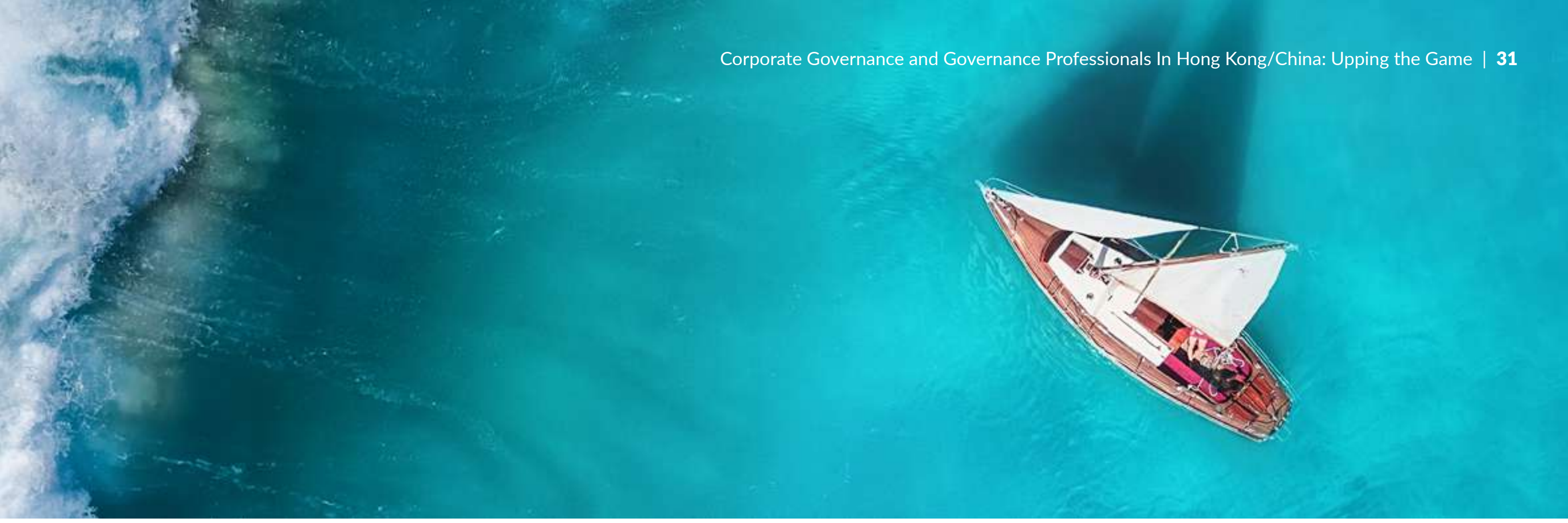
50 Coleman, J., 'Australia's epic wildfires expanded ozone hole and cranked up global heat', *Nature*, 01 September 2022 (https://www.nature.com/articles/d41586-022-02782-w)

51 Masters, J., 'World rocked by 29 billion-dollar weather disasters in 2022', *Yale Climate Connections*

52 The Washington Post, 'Climate change in Hong Kong worsens housing crisis for city's poor', 12 September 2022 (https://www.washingtonpost.com/world/2022/09/12/hong-kong-heat-roof-huts-climate/)

53 The New York Times, '20 Nations at High Risk From Global Warming Might Halt Debt Payments', 14 October 2022 (https://www.nytimes.com/2022/10/14/climate/climate-disasters-poor-nations-iimf.html)

54 Estevão, M. and Essl, S., 'When the debt crises hit, don't simply blame the pandemic', *World Bank Blogs*, 28 June 2022 (https://blogs.worldbank.org/voices/when-debt-crises-hit-dont-simply-blame-pandemic)



4.2 Current efforts towards a green global economy

According to the Intergovernmental Panel on Climate Change, large-scale policy changes must be urgently implemented to minimise climate risks and limit catastrophic climate disruptions.[55] Global emissions must decline by 43 per cent by 2030 to meet the target of limiting global warming to 1.5°C[56] and achieve net carbon neutrality by 2050 as stipulated in the 2015 Paris Agreement.[57] Doing this requires higher taxes on greenhouse gas (GHG) emissions, more regulation, significant investments in low-carbon technologies, and greater effort by advanced economies and emerging markets to reduce emission activities.

Governments, organisations, regulators, and companies are engaging in global cooperation. They recognise the responsibility to mitigate climate risks by reducing and controlling emissions activities, the importance of achieving a green global economy, and the role that private sector investment and the financial sector can play in performing this task. The International Organization of Securities Commissions (IOSCO) set up a Sustainability Task Force to improve the comparability of climate disclosures. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) considers the prudential regulation of bank balance sheets in ways that reflect climate risk principles, while the EU's International Platform on Sustainable Finance is promoting better cooperation among authorities, banks and national governments.[58]

Efforts in Hong Kong include the establishment of the Green and Sustainable Finance Cross-Agency Steering Group (Steering Group), with the participation of the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Environmental Bureau, the Financial Services and the Treasury Bureau (FSTB), Hong Kong Exchanges and Clearing Limited (HKEX), the Insurance Authority (IA), and the Mandatory Provident Fund Schemes Authority (MPFA).[59] The Steering Group examines regulatory and policy issues related to green and sustainable finance, especially those that may impact other sectors, and coordinates policies to achieve a comprehensive green and sustainable finance strategy. It collaborates with experts and stakeholders through technical working groups to address technical cross-sectoral issues. Also, Hong Kong has committed to adopting the Task Force's recommendations on Climate-related Financial Disclosures (TCFD). This span the four crucial areas of governance, strategy, risk management, and metrics and targets to help companies embed globally accepted standards for financial risk reporting and climate change disclosures in their governance and risk management frameworks.[60]

55 International Monetary Fund, 'World Economic Outlook: Countering the Cost-of-Living Crisis', October 2022 (https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022)

56 McKenzie, J., 'IPCC report calls for rapid, deep, and immediate emissions reductions', *Bulletin of the Atomic Scientists*, 6 April 2022 (https://thebulletin.org/2022/04/ipcc-report-calls-for-rapid-deep-and-immediate-emissions-reductions/)

57 International Monetary Fund, 'World Economic Outlook: Countering the Cost-of-Living Crisis', p. 71

58 Securities and Futures Commission, 'Climate change and finance: What's next for global regulators? Climate Risk and Green Finance Regulatory Forum 2021', *Speech by Mr Ashley Alder, Chief Executive Officer of the SFC*, 11 February 2021 (https://www.sfc.hk/-/media/EN/files/ER/PDF/CEO_Speech_Climate-Risk-and-Green-Finance-Regulatory-Forum-2021.pdf)

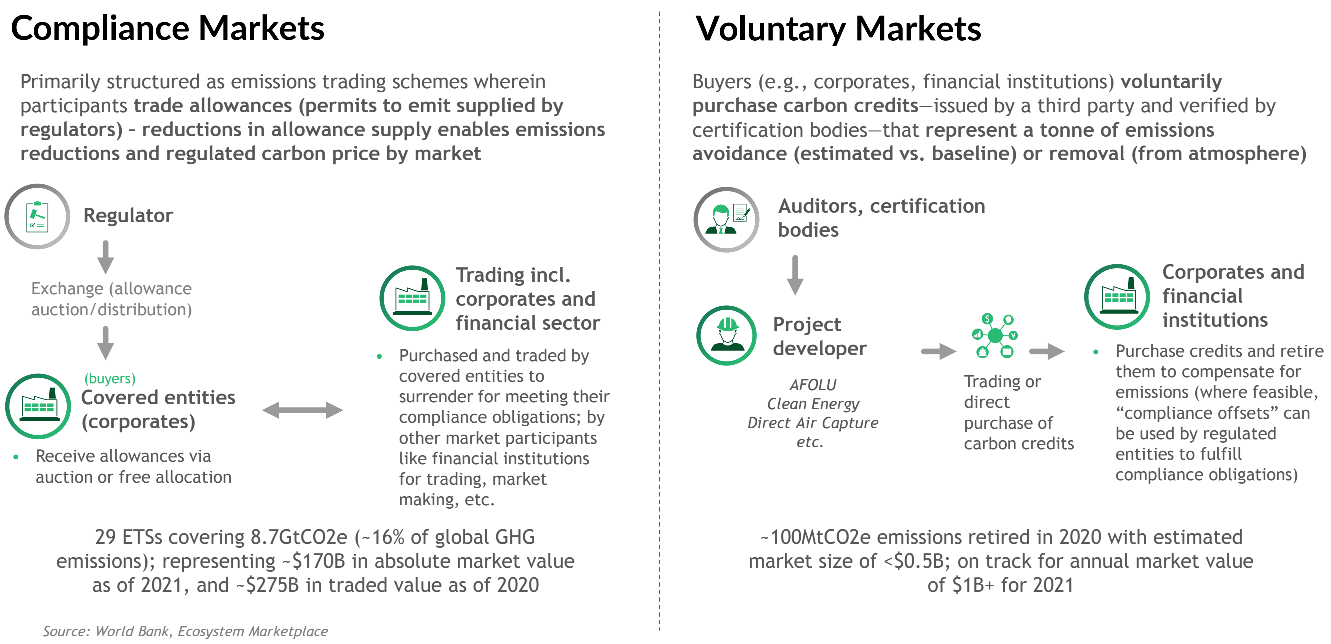
59 Hong Kong Monetary Authority Press Release, 'Joint statement on the establishment of the Green and Sustainable Finance Cross-Agency Steering Group', 05 May 2020 (https://www.hkma.gov.hk/eng/news-and-media/press-releases/2020/05/20200505-8/)

60 Securities and Futures Commission, 'Climate change and finance: What's next for global regulators? Climate Risk and Green Finance Regulatory Forum 2021', *Speech by Mr Ashley Alder, Chief Executive Officer of the SFC*

4.3 Carbon pricing as a tool to regulate emissions activities

Mr Ashley Alder, Chair of the IOSCO, emphasised the urgent need to address climate change threats through retooling the financial system, and one such tool is carbon pricing.[61] Carbon markets come in two types: (1) voluntary carbon markets (VCMs), where buyers purchase carbon credits of projects that remove GHG emissions, each representing a ton of emissions removal, to compensate for their emissions. Also, (2) compliance markets such as the European Union Emissions Trading System (EU ETS), where market participants trade allowances (permissions) from regulators to emit a ton of carbon emissions (Figure 7).[62]

Figure 7. High-level description of the compliance and voluntary carbon markets



Source: Green and Sustainable Finance Cross-Agency Steering Group Carbon Market Workstream

Carbon credits, allowances, and other derivatives provide incentives to limit emissions costs and enhance market transparency. Market participants may opt to lower their emissions to save the costs of purchasing allowances, thus enabling emission reductions. The Carbon Market Workstream of the Hong Kong Steering Group suggests that the demand for carbon credits as an asset class may grow. This follows the growing market interest in VCMs, the threat of the EU's carbon tax on imported goods, and the increasing number of firms and countries implementing decarbonisation strategies using carbon credits while working on their carbon neutrality goals. Furthermore, companies listed on the HKEX are encouraged to decarbonise as the HKEX publishes its Net-Zero Guide and strengthens its ESG reporting requirements on firms.[63] With China being the current largest carbon market in the world, thrice that of the EU according to Forbes[64], there are potential carbon market opportunities in Hong Kong, given its status as an international financial centre and a regional certification hub. The Carbon Market Workstream further mentions a need for a platform to trade emission rights and financial services in the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) to allow qualified foreign investors to participate. This raises the need for market structures to connect investors with the carbon markets on the Mainland.[65]

61 Ibid.

62 Green and Sustainable Finance Cross-Agency Steering Group Carbon Market Workstream, 'Carbon Market Opportunities for Hong Kong: Preliminary Feasibility Assessment', March 2022 (https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2022/20220330e3a1.pdf)

63 HKEX, 'HKEX Publishes Net-Zero Guide & Announces New ESG Data Display', 02 December 2021 (https://www.hkex.com.hk/News/News-Release/2021/211202news?sc_lang=en)

64 Busch, C., 'China's Emissions Trading System Will Be The World's Biggest Climate Policy. Here's What Comes Next.', *Forbes*, 18 April 2022 (https://www.forbes.com/sites/energyinnovation/2022/04/18/chinas-emissions-trading-system-will-be-the-worlds-biggest-climate-policy-heres-what-comes-next/?sh=30f1bf462d59)

65 Green and Sustainable Finance Cross-Agency Steering Group Carbon Market Workstream, 'Carbon Market Opportunities for Hong Kong: Preliminary Feasibility Assessment'

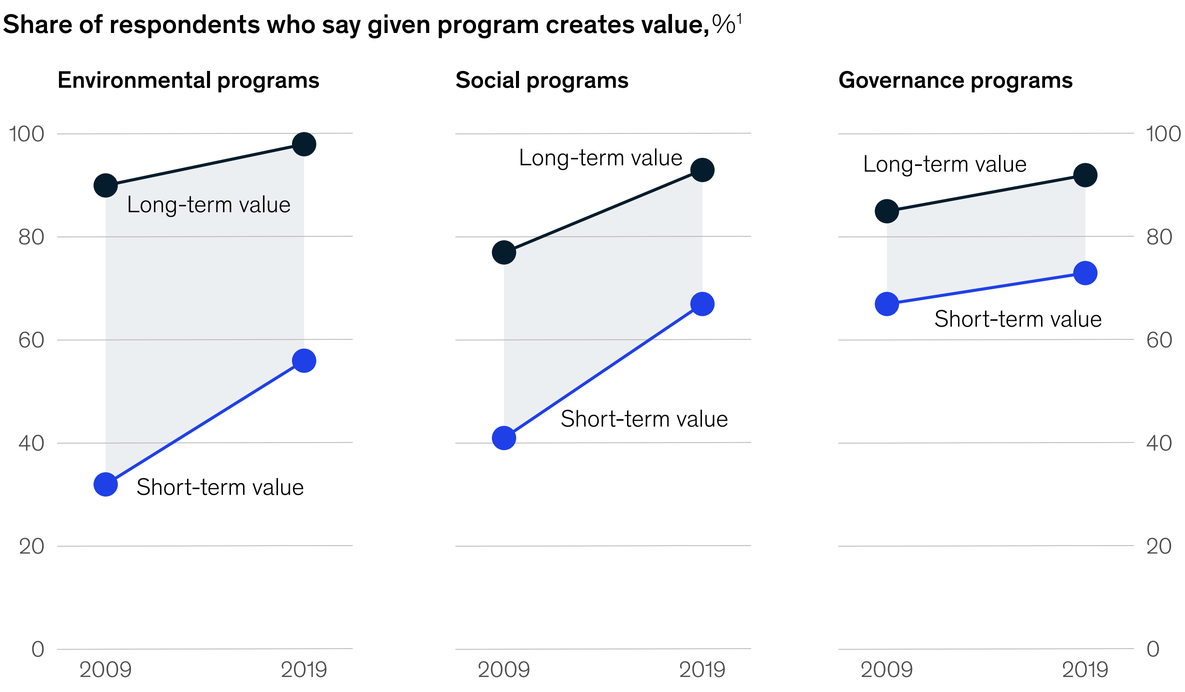
Nevertheless, VCMs are still largely unregulated in Hong Kong, except for carbon derivatives that fall under the supervision of the SFC.[66] The market is not standardised, and transactions take place over the counter. Carbon credits may be purchased directly from project owners, local consultants and brokers.

The lack of transparency and scalability of these transactions poses a challenge. Buyers may also face difficulties distinguishing the differences across VCMs, and hence struggle to conduct due diligence on the projects that underpin these credits.

4.4 The role of ESG and Corporate Governance

Companies face pressure to incorporate environmental, social, and governance (ESG) factors in their business operations to improve company performance, create shareholder value, and maintain a competitive advantage over competitors. Business leaders, executives and investment professionals consider that ESG programs create both short-term and long-term value, with the perceived long-term value rivalling or exceeding that of corporate governance programs (Figure 8). Some investment professionals consider a good ESG track record a factor when determining whether or not to invest in a company, with 25% willing to pay a 20 - 50% premium for companies with a good record.[67] This necessitates stricter requirements for ESG reporting. Investment professionals, for example, require standardised ESG data that can be readily benchmarked and integrated with financial data.

Figure 8. Among respondents who say ESG programs create value, the share seeing short-term and long-term value has grown



[1]Question was asked only of respondents who said environmental, social, and governance programs increase shareholder value. Respondents who said "substantially negative," "negative," or "no effect" are not shown; total n = 136 in 2009 and n = 342 in 2019.

McKinsey & Company

66 Ibid.
67 KPMG and HKCGI, 'Risk management survey: Empowering success', p. 16, 24 November 2020 (https://home.kpmg/cn/en/home/insights/2020/11/risk-management-survey-empowering-success.html); McKinsey & Company, 'The ESG premium: New perspectives on value and performance', 12 February 2020 (https://www.mckinsey.com/capabilities/sustainability/our-insights/the-esg-premium-new-perspectives-on-value-and-performance)

Sustaining value requires a willingness to change paradigms and adapt to the evolving expectations of stakeholders, who must perceive that the company is performing in a just, fair, and appropriate way deserving of trust.[68] The ESG framework takes a holistic view of an organisation's sustainability by moving beyond environmental issues to include social and governance factors. It helps stakeholders understand how organisations manage risks and opportunities in these key areas. The Environmental criteria include greenhouse gas emissions, proper use and care towards natural resources, and resilience towards climate risks, such as climate change and natural disasters. The Social component deals with the way the organisation interacts with its people and community, covering issues such as employee health and safety, labour relations between management and workers, and policies on diversity, equity and inclusion. Governance pertains to how a company and its internal controls and processes are managed, how shareholder rights and interests are viewed, and how leadership views align with stakeholder expectations. While ESG initially revolved around sustainability-focused strategies and the regulatory frameworks of Environmental, Health, and Safety (EHS), corporate sustainability, and corporate social responsibility, it has evolved to include environmental and social impacts and governance structures for the welfare and interests of all stakeholders.[69]

The increased emphasis on ESG is not without its critics. Some critics argue that it is merely a public relations tactic to get customers, investors or employees to view the brand favourably, while others have cast it as greenwashing.[70] Striking a balance in meeting each of the E, S, and G components to accommodate multiple stakeholders is also challenging. As corporate governance goes beyond narrow shareholder interests to serve all stakeholders, there is the question of who is entitled to the incremental benefit. Lastly, there are different methods and standards of measuring ESG along with other considerations, ratings and analyses, which make it hard to come up with a unified understanding of good ESG performance. Each ESG component has different metrics and assessments and varying evaluation methods. For example, in the Social component, qualitative questions may be used to assess how a company tracks human rights abuses. At the same time, quantitative methods apply in measuring the percentage of racial diversity in the organisation or compensation gaps between employees. It is hard to obtain a standardised measurement of social risks and their potential financial impacts due to multiple influential factors such as the company size and industry type.

68 McKinsey & Company, 'Does ESG really matter – and why?', *McKinsey Quarterly*, 10 August 2022 (https://www.mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why)

69 Peterdy, K., 'ESG (Environmental, Social and Governance)', *Corporate Finance Institute*, 30 August 2022 (https://corporatefinanceinstitute.com/resources/knowledge/other/esg-environmental-social-governance/)

70 McKinsey & Company, 'Does ESG really matter – and why?'

4.5 ESG regulation

US, Europe, and Hong Kong regulators require mandatory ESG and climate change reporting.[71] There is growing support for higher standards in integrating ESG factors in financial services, market integrity, and consumer protection goals.[72] The HKEX published a voluntary ESG reporting guide which has now become mandatory, and in 2020 was further amended to incorporate recommendations of the Task Force on Climate-Related Financial Disclosures ('TCFD') of the Financial Stability Board.[73] Hong Kong issuers are now required to submit an ESG report that conforms to four reporting principles of materiality, quantitative, balance, and consistency, along with a board statement that states its overall responsibility for ESG reporting, its strategy and its consideration and oversight of ESG matters. To allow flexibility, the ESG Reporting Guide also includes 'comply or explain' provisions in which listed companies must explain the reasons behind the non-disclosure of some aspects in each ESG area.[74]

Meanwhile, in September 2022, the Hang Seng Index's Company announced its ESG ratings of listed companies using an annually reviewed sustainability assessment that incorporates a periodic consideration of emerging sustainability issues.[75] The assessment found that more and more companies align their business strategies with global standards to strengthen their ESG management. There is an emerging trend of companies adopting the TCFD recommendations for climate-related financial disclosures. Furthermore, the ESG Steering Group announced that by 2025, climate-related reporting would be required in Hong Kong, so disclosure requirements will be further amended to include additional questions that relate to carbon neutrality and its impact on climate.

New opportunities and ESG assets become available. For instance, the HKEX launched its Sustainable and Green Exchange (STAGE) initiative to promote its sustainable and green finance investment products, such as 'green bonds' or bonds with Green Finance Certification approved by the Hong Kong Quality Assurance Agency (HKQAA).[76] Other related financial products include 'social bonds', ESG money market funds, 'green loans', and 'sustainability-linked' loans.[77] Financial investment products go through an external green assessment to obtain these certifications to certify that there are environmental benefits in the financing of investments by green finance issuers.

With increased ESG regulation also come the risks of regulatory enforcement and litigation. For instance, financial institutions risk being accused of 'greenwashing', which is providing false information or deliberately omitting material facts to manipulate or induce transactions in financial products.[78] This puts companies under greater scrutiny in whether their practices, disclosures and ESG strategies match. Companies could face legal action or be subject to regulatory fines when the 'greenness' of a financial product is overstated. Different regulators also have their regulatory enforcement action according to their requirements. For example, the HKMA's Supervisory Policy Manual includes a new module ('GS-1') to guide banks on HKMA's expectations of risk management frameworks related to climate risks. Banks were required to comply by December 2022. Otherwise, they run the risk of regulatory enforcement actions.

Similarly, HKEX has disciplinary powers over listed entities that breach listing rules on ESG reporting. At the same time, IPO sponsors who fail to conduct ESG due diligence are subject to enforcement actions like fines from the Securities and Futures Commission ('SFC'). Breaches in the 'S' and 'G', such as human rights violations, bribery and corruption, are also subject to Hong Kong labour and corruption laws. It would appear the list of items and range of issues.

71 Barclays, '10 ESG themes for 2022: The transition mission', 10 March 2022 (https://www.cib.barclays/our-insights/10-esg-themes-for-2022.html)

72 McCormack, U. and Tear, L., 'Hong Kong's ESG regulatory framework and emerging enforcement and disputes risk', *King & Wood Mallesons*, 22 June 2022 (https://www.kwm.com/hk/en/insights/latest-thinking/HK_ESG_regulatory_framework_and_emerging_enforcement_and_disputes_risk.html)

73 HKEX, 'Guidance on Climate Disclosures', November 2021 (https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Environmental-Social-and-Governance/Exchanges-guidance-materials-on-ESG/guidance_climate_disclosures.pdf)

74 HKEX, 'Appendix 27 Environmental, Social and Governance Reporting Guide', *Rules and Guidance*, January 2022 (https://en-rules.hkex.com.hk/rulebook/environmental-social-and-governance-reporting-guide-0)

75 Hang Seng Indexes, 'Hang Seng Index's Company Announces 2022 Sustainability Ratings of Listed Companies', *Hang Seng Index's Company Press Release*, 8 September 2022 (https://www.hsi.com.hk/static/uploads/contents/en/news/pressRelease/20220908T000000.pdf)

76 HKEX, 'Making inroads into good Corporate Governance and ESG management – Perspectives from industry practitioners', December 2020 (https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Corporate-Governance-Practices/Practitioners_insights.pdf?la=en)

77 McCormack, U. and Tear, L., 'Hong Kong's ESG regulatory framework and emerging enforcement and disputes risk'

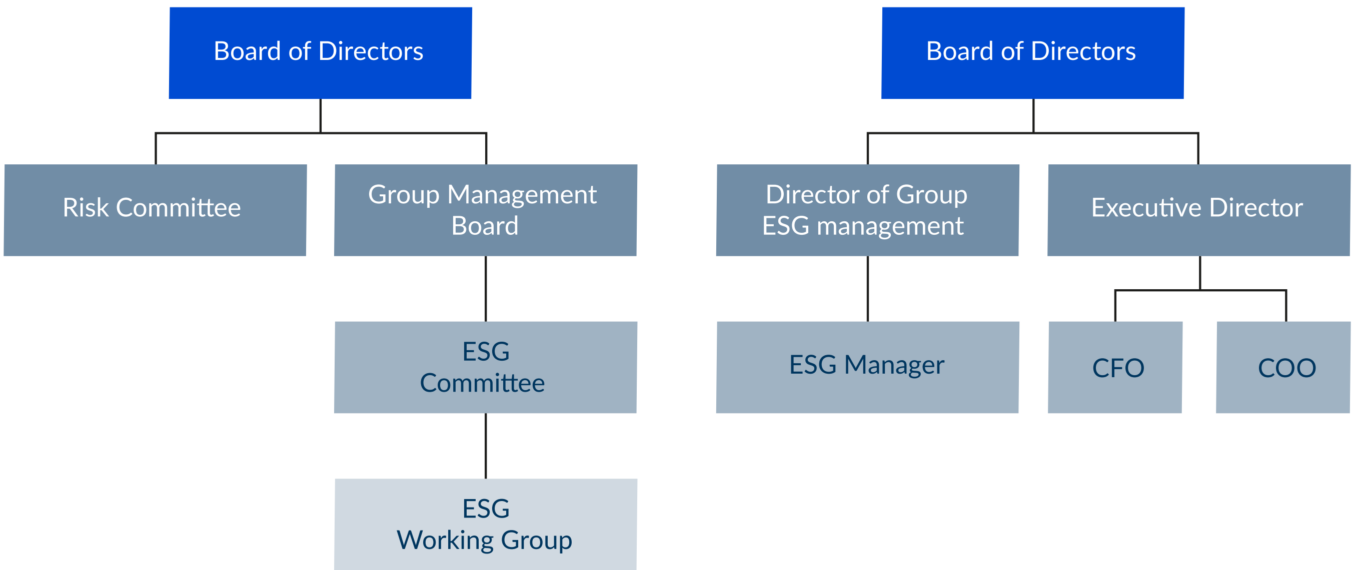
78 Ibid.

4.6 ESG and the Board

ESG is an increasingly significant aspect of the board's work. Regulatory requirements are increasing, and good ESG performance may help raise funds, green bonds and credit lines and attract the right investors.[79] For this reason, ESG is no longer a secondary niche area entrusted to a sustainability officer but occupies a more central place in the function of boards. The board is responsible for ESG reporting and establishing the company's strategy and management approach. Doing so requires a solid governance system that establishes ESG as a key position in the corporate governance structure (Figure 9).[80] In Hong Kong, directors must now evaluate the risks and opportunities associated with ESG in discharging their duties.[81] Boards must have a thorough and adequate understanding of the environmental and social impacts of the company and continuously upskill in this area by obtaining regular professional training sessions. They may invite experts that can provide professional advice on issues that are material to the business or appoint new board members with relevant expertise, qualifications, or significant experience in corporate governance and ESG matters.

Moreover, companies can harness the power of digital technology to improve ESG reporting. Digital technology may also help companies analyse ESG-related data and make better evaluations or projections.[82] The role of company secretaries/ governance professionals is crucial in supporting the board in ensuring regulatory compliance, establishing and monitoring effective systems, communicating with shareholders, and handling ESG matters that do not need to reach the board level.[83]

Figure 9. Governance structures that incorporate ESG



Source: HKEX

79 Ernst & Young, 'Will there be a 'next' if corporate governance is focused on the 'now'? – EY Long-Term Value and Corporate Governance Survey', February 2021 (https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/long-term-value/ey-corporate-governance-survey-february-2021-v2.pdf)

80 HKEX, 'Making inroads into good Corporate Governance and ESG management – Perspectives from industry practitioners', p. 5

81 The Hong Kong Chartered Governance Institute, 'Legal Developments in Directors' Duties and ESG: What Every Hong Kong Company Director Should Know', 25 November 2022 (https://www.hkgreenfinance.org/research-report/legal-developments-in-directors-duties-and-esg/)

82 Choi, M., 'How digital tech can help companies improve ESG reporting, fight climate change', *South China Morning Post*, 16 October 2022 (https://www.scmp.com/business/companies/article/3195956/how-digital-tech-can-help-companies-improve-esg-reporting-fight)

83 HKEX, 'Making inroads into good Corporate Governance and ESG management – Perspectives from industry practitioners', p. 23

4.7 Section conclusion

Climate risks have increased to levels that necessitate urgent climate action. Governments, businesses and societies are urged to prioritise reducing GHG emissions. The transition to a carbon-neutral world will be costly, but the long-term costs of inaction may be more significant, and they will be felt more by vulnerable countries and low-income economies. Carbon markets have developed as one of the tools for doing so but remain largely unregulated. New financial innovations emerge to tackle these problems. The need for regulatory compliance is increasing. Climate policies are having a significant impact on company valuations. More broadly, actions of an organisation's governance, the interaction with its people, the environment, surrounding communities and society at large, commonly referred to as ESG, are scrutinised.[84] Consequently, investors demand greater transparency on firms' ESG strategy and governance.

These changes necessitate accountability, transparency, and ownership of ESG strategies at the top level to drive long-term value. ESG has morphed into more than just socially responsible investments, and the failure to establish appropriate policies and procedures or regulatory non-compliance can give rise to significant risks that include legal action, reputational damage and financial loss. ESG is a key area that businesses must prioritise and embed in their corporate governance. Company secretaries/governance professionals must assume oversight of these policies.

HIGHLIGHTS AND TAKEAWAYS:

Given the severity of climate risks, climate action is urgent. While governments and organisations are engaging in a collaborative effort to fight climate change, much can also be done at a corporate level through good governance, for example, in the form of transparent climate change disclosures, effective risk management frameworks and compliance with regulations. Companies are urged to place a higher priority on reducing their GHG emissions.

There is increased pressure on companies by stakeholders to incorporate ESG factors in their business operations and a demand for transparency in their disclosures. With this pressure comes the need for companies to rethink their strategies and modify their ways. This also implies a reinvention of corporate governance whereby companies incorporate ESG and climate change issues in their financial and non-financial disclosures to enhance transparency and ensure accountability.

While there is increasing awareness of the short-term and long-term value of ESG initiatives, risks and criticisms such as 'greenwashing' also exist in the implementation of ESG programs that companies have to consider and pay attention to equally. Therefore, the role of corporate governance professionals necessitates oversight of all ESG activities.

Company secretaries/governance professionals in Hong Kong need to see matters concerning climate change and ESG as a vital part of their core duties to inform and advise the board. Furthermore, assisting in formulating company policies and overseeing compliance is integral to the role. The board should strengthen the company secretaries/governance professionals' authority to deal with internal and external stakeholders reporting to the board on developments.

84 HKEX, 'Making inroads into good Corporate Governance and ESG management – Perspectives from industry practitioners', p. 4

Section 5:

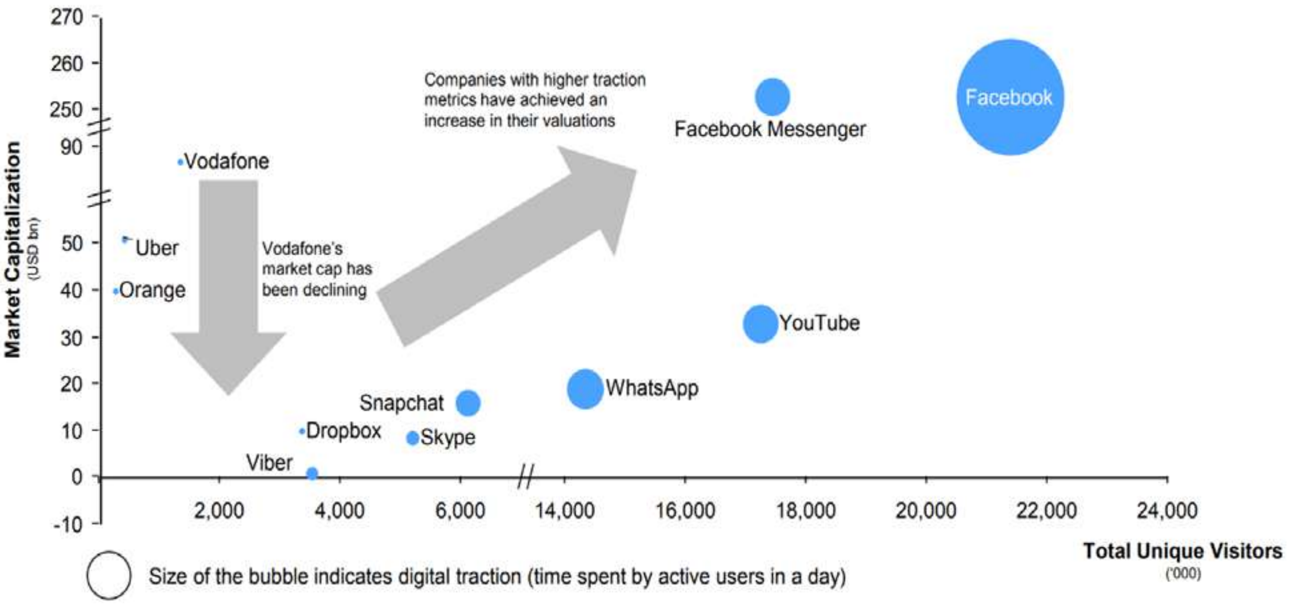
Emerging Technologies and Digital Transformation

Innovation and the emergence of new technologies are reshaping how we live, creating a more interconnected world which drives businesses to transform how they operate and add value. In Hong Kong, for example, an economic discourse has moved from real estate to start-ups, unicorns and tech entrepreneurs[85] The pandemic further demonstrated the advantages of adopting technology. It created an urgency to digitalise business processes and demanded business leaders incorporate new ways of thinking and doing. This integration of digital technologies and innovation to create value describes the digital transformation process.

5.1 Key trends in digital transformation and emerging technologies

Digital technology has developed from merely a promoter of efficiency to an enabler of fundamental innovation and disruption. Digitalisation, its most fundamental form, has enabled large-scale, sweeping transformations across multiple business areas, providing opportunities to capture and create value and new risks and challenges.[86] Digital business models have saved some companies from bankruptcy and produced new revenue streams, turning technology from a cost saver to a revenue generator. A Gartner/MIT CISR study found that companies that generate digital revenue have been growing 1.5% faster than their industry average. At the same time, another survey showed that 45% of IT executives believe that improving digital capabilities can foster revenue growth. Furthermore, Deloitte and OpenMatters research found that investors have been valuing companies with tech-driven business models more, whilst those with good 'digital traction have gained higher market capitalisation than their analogue peers (Figure 10).

Figure 10. Digital companies outperform analog incumbents in valuation

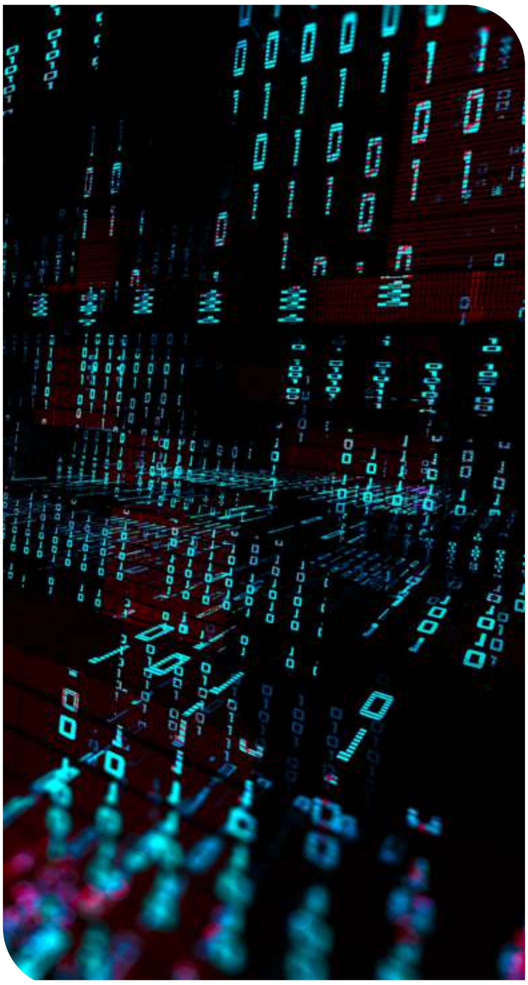


Source: Data extracted from ComScore and Bloomberg, World Economic Forum/Accenture Analysis

85 The Hong Kong Chartered Governance Institute, 'The tech challenge', *CGj*, 15 July 2019 (https://cgj.hkcgi.org.hk/2019/07/the-tech-challenge/)

86 World Economic Forum, 'Digital Enterprise', *World Economic Forum White Paper – Digital Transformation of Industries: In collaboration with Accenture*, January 2016 (https://reports.weforum.org/digital-transformation/wp-content/blogs.dir/94/mp/files/pages/files/digital-enterprise-narrative-final-january-2016.pdf)

There is growing support for companies and SMEs to adopt digitalisation. Hong Kong's Productivity Council provides extensive digitalisation services to enhance operational efficiency and enable market expansion according to the enterprise's specific needs. In contrast, Australia's Corporate Governance Institute provides research and advice on maturing, scaling and emerging technologies to help organisations drive innovation and increase their competence (Emerging Technologies Future Scan).[87] Dr George Lam, Chairman of the Hong Kong Cyberport Management Company Ltd, calls digital the 'new English' because young people will need to be tech-savvy and digitally literate when it comes to getting an education, a good job, or even finding a future partner.[88] Networking and social relationships have moved online with the rise of LinkedIn, social media platforms like Facebook, Instagram, Twitter, Weibo and TikTok, online dating apps such as Tinder and Bumble, and messaging apps like WhatsApp, WeChat, Facebook Messenger and Viber. Digital transformation is pervasive.



Accenture Technology Vision identifies five key emerging technology trends shaping the new digital landscape.

The Internet of Me: Users are placed at the centre of every digital experience through the personalisation and customisation options provided in apps and services.

Outcome economy: The internet's ubiquity has enabled businesses to measure the outcomes of their products and services. Customers notice more business models that sell results than those that merely sell products.

The Platform (r)evolution: Technological barriers and costs in establishing global platforms have been reduced by rapid advances in cloud and mobile connectivity, which opens more room for innovation and delivery of next-generation services.

The intelligent enterprise: With data science enabling the conversion of big data to smart data, firms can utilise smart machines and software intelligence to achieve higher operational efficiency and innovation levels.

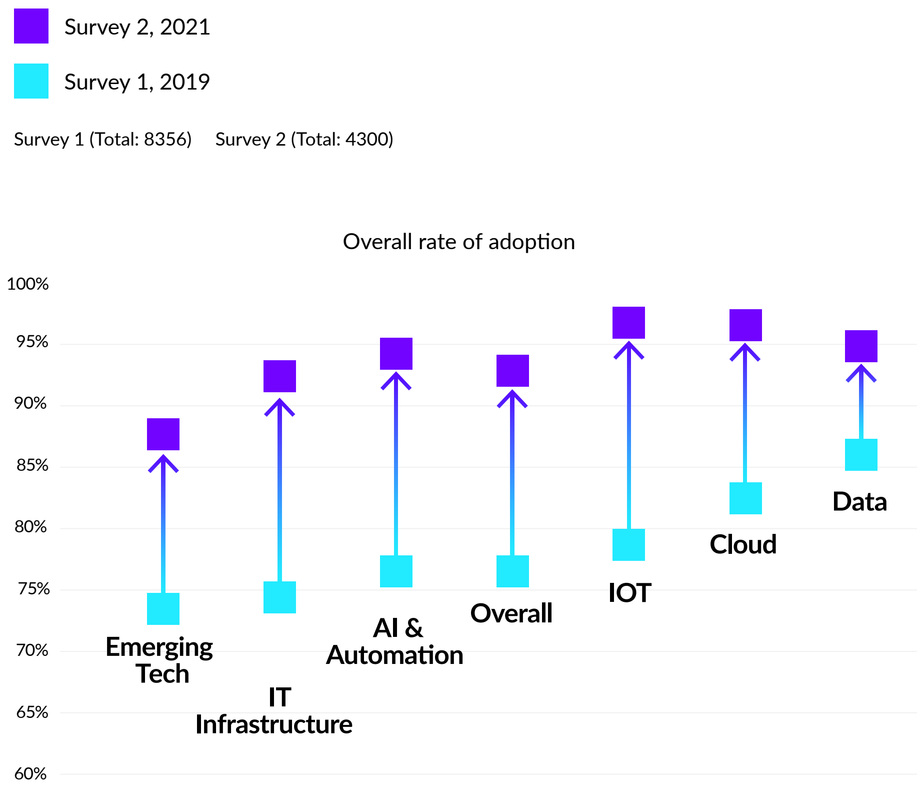
Workforce reimagined: There is a higher demand for machines and humans to work effectively together, as observed in advances in wearable devices, natural interfaces and smart machines that provide opportunities to empower human talent through technology.[89]

87 CGI Australia, 'Emerging Technologies Future Scan' v2.0 (https://www.cgi.com/sites/default/files/2019-10/emerging-technologies-future-scan-en.pdf)
88 HKCGI CGI, 'The tech challenge'
89 World Economic Forum, 'Digital Enterprise', *World Economic Forum White Paper – Digital Transformation of Industries: In collaboration with Accenture*, p. 6

To further understand the impact, Accenture surveyed more than 8,300 global executives in 2019 and 4,300 in 2021 and found that technology adoption has accelerated (especially due to the pandemic), although not equally (Figure 11). The emerging technologies with high adoption rates are the Internet of Things (IoT), Cloud and Data, and AI and automation.[90]

Faster data transfer and processes have eliminated inefficiencies of the past.[91] The Internet of Things is driving significant changes in the digital space by enabling a network of connected devices to create a digital ecosystem.[92] Artificial intelligence (AI) advancements allow new business models and big data technologies to convert data from multiple sources into meaningful information. Given the enormity and inevitability of technology's impact on businesses, it is important to learn how its benefits can be maximised and its risks minimised. These developments make business leaders need to take these trends on board when planning, executing and evaluating strategies.

Figure 11. Accelerated rate of tech adoption during the COVID-19 pandemic



Emerging tech: blockchain, extended reality, open source, 3D printing, robotics

IT Infrastructure: DevSecOps, serverless computing, cloud native applications, containers, docker and kubernetes, microservice architectures, distributed logs/event hubs, react/event driven architectures, FaaS.

AI & Automation: deep learning, machine learning

IoT: Internet of Things, edge/fog computing

Cloud: Saas, Iaas, Paas, hybrid cloud

Data: Data lakes/repository, streaming/real-time data, big data analytics

Notes: FaaS = Function-as-a-Service; SaaS = Software-as-a-Service; IaaS = Infrastructure-as-a-Service; and PaaS = Platform-as-a-Service.

Source: Accenture (2021). Make the Leap, Take the Lead. Available at https://www.accenture.com/_acnmedia/PDF-153/Accenture-Make-The-Leap-Take-The-Lead-Report.pdf.

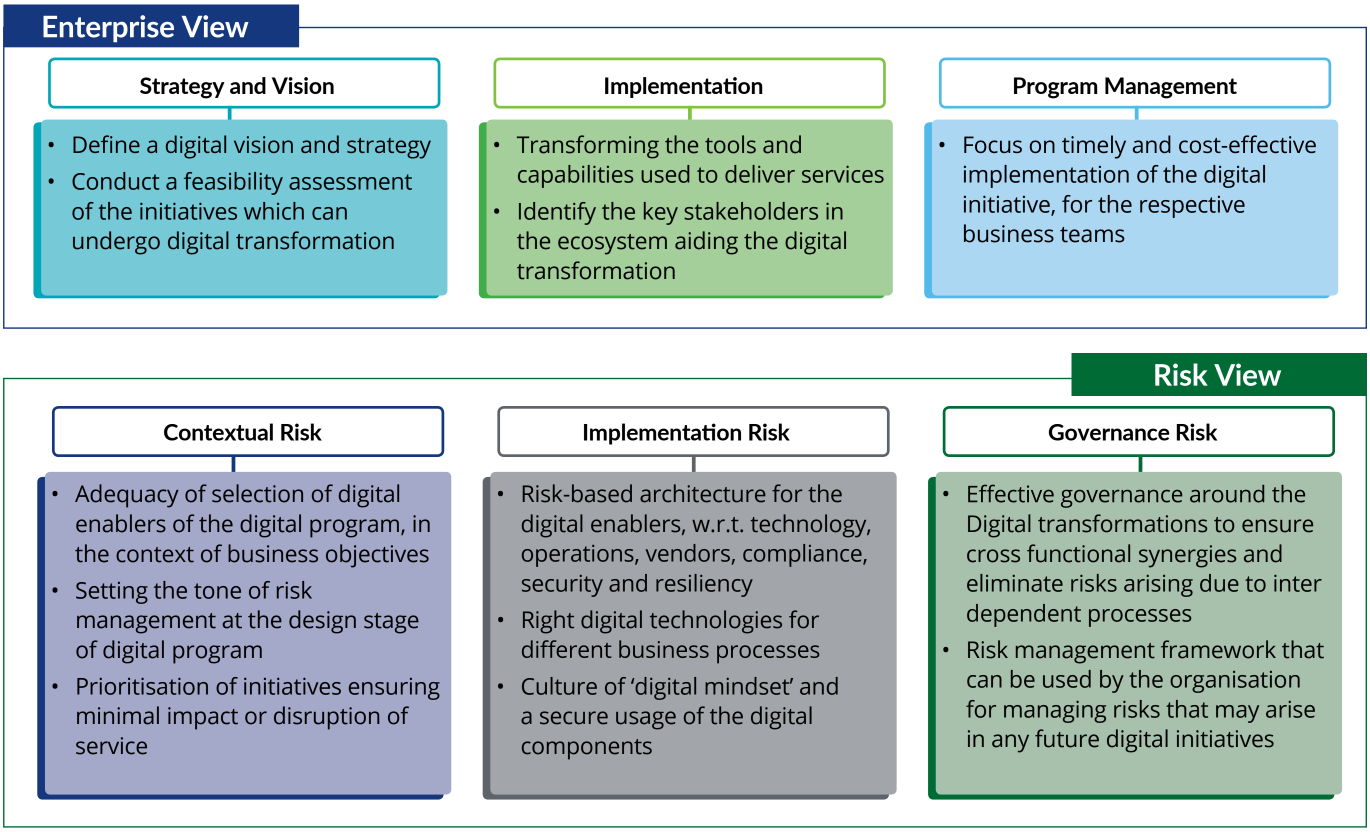
90 United Nations ESCAP Information and Communications Technology and Disaster Risk Reduction Division, 'Digital Transformation Landscape in Asia and the Pacific: Aggravated Digital Divide and Widening Growth Gap', July 2022 (https://repository.unescap.org/bitstream/handle/20.500.12870/4630/ESCAP-2022-WP-Digital-transformation-landscape-Asia%20Pacific.pdf)

91 Varoglu, A., Gokten, S., Ozdogan, B., 'Chapter 10 Digital Corporate Governance: Inevitable Transformation', *Financial Ecosystem and Strategy in the Digital Era*, Springer, June 2021 (https://www.researchgate.net/publication/352386759_Digital_Corporate_Governance_Inevitable_Transformation)

92 Deloitte, 'IoT Governance – Governance framework', 2021 (https://www2.deloitte.com/content/dam/Deloitte/xe/Documents/technology/me_IoT-Governance.pdf)

Technological innovation is not without risks. For example, companies are embracing cloud providers such as Apple, Amazon Web Services and Microsoft Azure to store and access data.[93] As this becomes more decentralised, it poses a challenge for organisations to allocate access rights to different users and ensure that all staff are responsible for the data they handle.[94] Deloitte outlines the impact of digital transformation from both an enterprise and a risk view (Figure 12).[95]

Figure 12. Impact of digitalisation from an enterprise and risk view



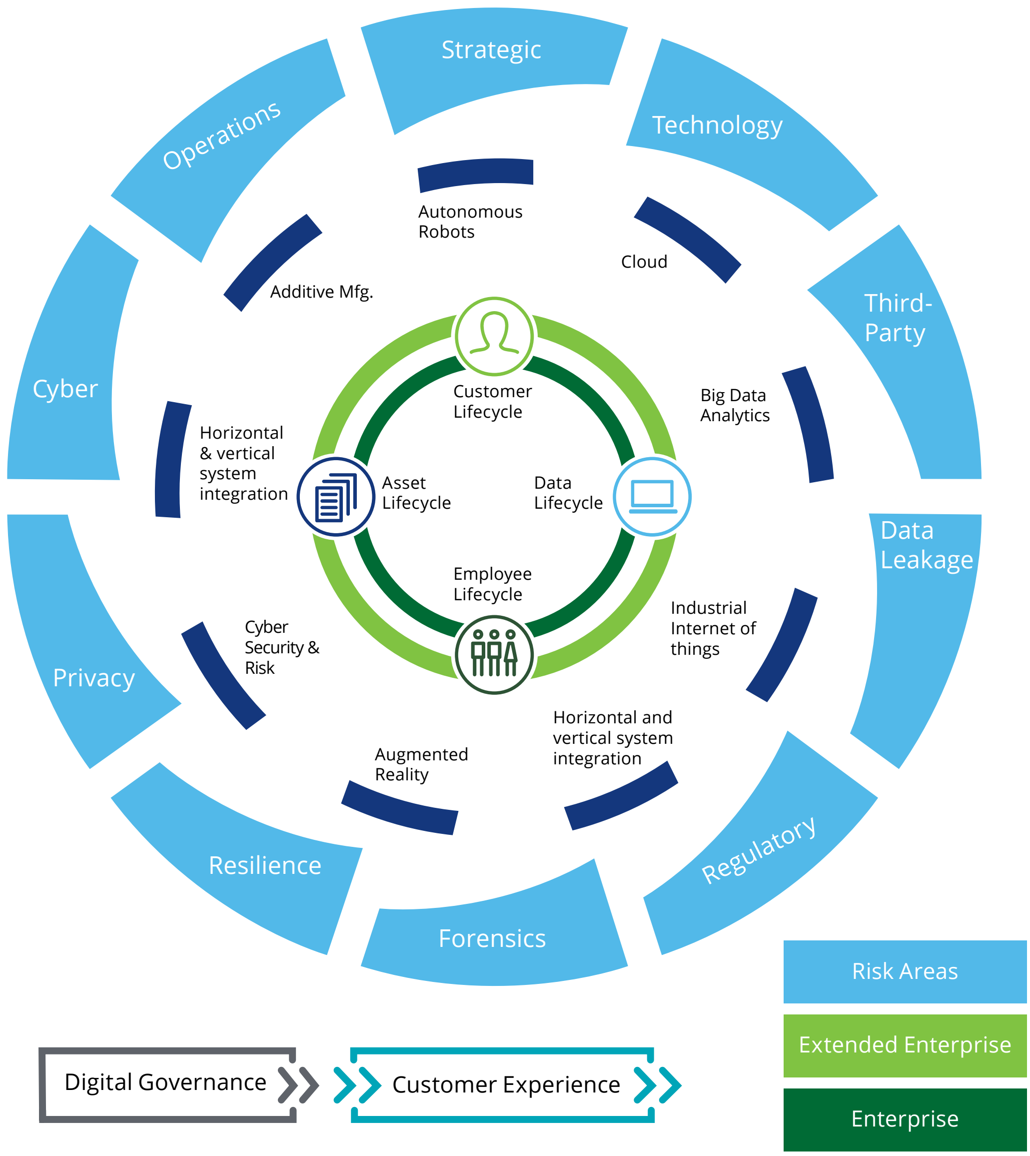
Source: Deloitte (2018)

93 The Hong Kong Chartered Governance Institute, 'Data governance and ethics', *CGj*, 16 September 2022 (https://cgj.hkcgi.org.hk/2022/09/data-governance-and-ethics/)

94 Ibid.

95 Deloitte, 'Managing Risk in Digital Transformation', 2018 (https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/in-ra-managing-risk-digital-transformation-1-noexp.pdf)

Figure 13. 10 key risk areas in Deloitte's digital risk framework



Source: Deloitte (2018)

They also identify ten risk areas other companies may face in their digital risk framework (Figure 13). This illustrates the need for companies to identify where their digital initiatives may create setbacks or where there might be constraints in implementing controls. This establishes a need for a digital risk strategy and framework to manage these risks and maintain digital resilience effectively.

Despite its benefits, technology adoption also has adverse impacts on various stakeholders. Reducing intermediaries also implies the elimination of jobs – affecting employees and suppliers, and by extension, customers. Technology also influences the relations between management, shareholders and stakeholder groups. The Pew Research Center gathered opinions on the impact of deploying AI and computer systems across society.[96] In their survey, 53% of respondents saw it as positive, while 33% said otherwise. Regarding robotic automation, 48% considered job automation a positive innovation, while 42% disagreed. Although a more significant proportion of the respondents offered positive feedback, many still consider technology's influence unfavourable. The study also found that the unintended impact of tech adoption included job insecurity, technostress and negative employee experiences. In the case of blockchain, effective governance may be necessary to prevent errors.

96 Malik, N., Tripathi, S. N., Kar, A. K., & Gupta, S., 'Impact of artificial intelligence on employees working in industry 4.0 led organizations', *International Journal of Manpower*, 19 May 2021 (https://www.emerald.com/insight/content/doi/10.1108/IJM-03-2021-0173/full/html)

5.2 The role of social media

Social media is arguably the most potent tool in changing today's business landscape. Platforms such as TikTok and YouTube facilitate a shared economy by allowing users to create and monetise their content, essentially empowering them to participate in the market and be entrepreneurs of their own. More importantly, the predictability of immediately available data gives any stakeholder a presence. It is disrupting the traditional stockbrokers' business model of relying on close personal relationships with clients as self-directed online trading is becoming popular among a younger generation of retail investors. An SFC survey found that online brokers are developing their social media platforms to gain followers and potential clients.[97] A study found empirical evidence of social media's influence on the acquisition decisions of potential acquirers when they rely on the predictive information extracted from social media to evaluate the potential returns of the acquisition.[98] After considering and controlling other factors that affect a firm's decision to withdraw an acquisition attempt, the study found that the likelihood of managers withdrawing a previous effort of privately targeted acquisitions is positively associated with the social media criticisms posted by small shareholders on the internet stock message board. The predictive ability of social media criticisms was found to increase with the information quality of postings. Effectively, these criticisms supplement the information delivered by institutional investors, analyst reports and the traditional media. In addition, message board criticisms were also seen to affect governance outcomes beyond acquisition decisions. All of these imply that social media has a considerable influence even on shareholders when they use it as a platform to tap into the wisdom of crowds and a vehicle for sharing value-relevant information. Hence, companies have to consider social media's presence, given its power and influence over stakeholders.

5.3 The rise of Regulatory Technology (RegTech)

Technology is a double-edged sword. It creates new forms of inconvenience, challenges and offences such as cybercrimes, fraud, money laundering and terrorism financing. In Hong Kong, online scam cases have risen to 14,160, while online investment fraud alone amounted to HK$540 million, contributing to an estimated loss of HK$2.6 billion in the first eight months of 2022.[99] The collapse of the cryptocurrency-exchange FTX has highlighted the risks of poor understanding and supervision of new technologies. Crypto companies like Binance have also suffered from hacks and digital theft that caused enormous financial loss and temporary suspension of transactions.[100]

These challenges justify the need to govern the use of new technologies. In a keynote speech delivered by Julia Leung, Deputy CEO and Executive Director for Intermediaries of the Securities and Futures Commission, at the 2022 ASIFMA Tech & Ops Conference, she emphasised the importance of building resilience and innovation in times of change and significant disruptions by capturing the benefits of new technology in delivering innovate products while minimising untoward disruptions brought by it. Such concerns have led to the development of RegTech, the technology-enabled management of regulatory processes within the financial industry, with primary

97 Securities and Futures Commission, 'Resilience and innovation in times of change – Keynote speech at ASIFMA Tech & Ops Conference 2022 by Julia Leung', 6 October 2022 (https://www.sfc.hk/-/media/EN/files/COM/Speech/ASIFMA-Tech-Op-Forum-Oct-22---Eng_20221006.pdf)

98 Ang, et al., 'The Role of Social Media in Corporate Governance', *The Accounting Review Vol. 96, No. 2, p. 1-32*, March 2021 (https://publications.aaahq.org/accounting-review/article-abstract/96/2/1/4255/The-Role-of-Social-Media-in-Corporate-Governance?redirectedFrom=fulltext)

99 Lo, C., 'Hong Kong fraud victims lose HK$2.6 billion as scammers peddle bogus cryptocurrency investments, fake jobs, romance', *South China Morning Post*, 9 October 2022 (https://www.scmp.com/news/hong-kong/law-and-crime/article/3195266/hong-kong-fraud-victims-lose-hk26-billion-scammers)

100 The Guardian, 'World's largest crypto exchange hacked with possible losses of $500m', 7 October 2022 (https://www.theguardian.com/technology/2022/oct/07/binance-crypto-hack-suspended-operations)

functions including regulatory monitoring, reporting, and compliance.[101] RegTech assists compliance departments in reducing risks by offering data on fraudulent online activities and monitoring transactions in real time to help identify irregularities using big data and machine-learning technologies. Financial institutions can identify potential threats and minimise risks and costs related to lost funds and data breaches. The challenges faced by financial institutions and the banking industry due to the pandemic led to the increased use of RegTech to keep vital banking services available despite rapidly changing circumstances.

Firms and institutions in Hong Kong have been tackling this through the use of regulatory technology (RegTech) that harnesses the power of new technologies such as Cloud, AI and Blockchain to improve the effectiveness and efficiency of activities on governance, risk management, and compliance (GRC).[102] The HKMA has been working collaboratively with the banking sector to encourage the broader use of RegTech in combatting cybercrimes and money laundering. The adoption of RegTech accelerated as a result of the pandemic. Among these initiatives are the Anti-Money Laundering and Counter-Financing of Terrorism (AML/CFT) RegTech Forum in November 2019,[103] a published report on case studies and insights on RegTech, and the launching of an AML RegTech Lab or AMLab on the use of network analytic techniques to identify fraud mule account networks.[104] Banks and financial institutions are either trying to upgrade their existing solutions or implement GRC RegTech solutions due to increased regulatory expectations and the pressure on risk and compliance departments to balance costs and effectiveness. Around 90% of all retail banks in Hong Kong have launched or plan to launch RegTech solutions. The Hong Kong Monetary Authority (HKMA) Fintech Supervisory Sandbox enables testing these initiatives. Key insights learned from AML/CFT RegTech adoption include the importance of early and continuing stakeholder buy-in, the need for interdisciplinary adoption teams with broad perspectives, the value of forums to share views and experience, and the ability to track and measure success. Other challenges include fragmented governance due to a lack of business and risk transparency, inadequate risk ownership that ultimately hinders the proper monitoring of compliance requirements, outdated reporting methods and traditional solutions that cannot provide data analysis and visualisation tools, and the fact that there is no one-size-fits-all approach.

5.4 Effective digital transformation and the role of good corporate governance

Technology has long been recognised as necessary in developing corporate governance practices.[105] Given the enormity and inevitability of technology's impact on business, learning how benefits can be maximised and risks minimised is essential. This starts with understanding how technology can influence corporate governance practices. In the digital economy, digital assets have become necessary, and data is the most valuable of them. Becoming a digital enterprise requires companies to consider three key areas – digital business models, digital operating models, and digital talent and skills – to enable digital transformation and survive digital disruption. Adopting digital business models requires redefining what they do and how they identify themselves when launching and developing new business ventures. They must establish how they conduct and operate the business through digital operating models and acquire the digital talent and skills they need to succeed. Lastly, organisations must create an innovative culture enabling these three key areas to function and develop.

101 Frankenfield, J., 'What You Should Know About RegTech', *Investopedia*, 27 August 2020 (https://www.investopedia.com/terms/r/regtech.asp)

102 Hong Kong Monetary Authority & KPMG, 'RegTech Adoption Practice Guide', p. 20, *Issue #3: Governance, Risk and Compliance*, September 2021 (https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20210927e1a1.pdf)

103 Hong Kong Monetary Authority and Deloitte, 'AML/CFT RegTech: Case Studies and Insights', January 2021 (https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20210121e1a1.pdf)

104 Hong Kong Monetary Authority, 'Opening Keynote Speech at Fraud and Financial Crime Asia 2022 Conference', 13 July 2022 (https://www.hkma.gov.hk/eng/news-and-media/speeches/2022/07/20220713-1/)

105 Varoglu, A., Gokten, S., Ozdogan, B., 'Chapter 10 Digital Corporate Governance: Inevitable Transformation'

Anette Bronder, digital transformation specialist and Group Chief Operating Officer at Swiss Re highlights good corporate governance's role in meeting what she considers the three critical requisites for effective digital transformation: transparency, traction, and talent.[106]

Transparency:

Digital transformation calls for a new era of corporate governance where boards are flexible, a virtual network of people with shared leadership approaches work together, and the committee structure reflects flexible agendas built around learning and knowledge management. To do this, companies must heed stakeholders' call for transparency and risk control, especially from more significant institutional shareholders. Furthermore, this transparency must be observed in the company's internal environment by becoming a workplace that fosters open communication and high employee engagement where people prefer to work. Organisations must set the appropriate level of transparency in their business so that employees can innovate and experiment without fearing management surveillance.[107]

Traction:

It is crucial for digital transformation to be accepted, supported, and acknowledged as a valuable enabler across the company. Platforms can be standardised when an integrated strategy and infrastructure protect them. Transparent corporate governance is needed on the executive level, where an integrated tech leader team works together to drive the innovation process. With the use of big data, companies can analyse the enormous amount of data produced on social media through users' comments, actions, purchasing behaviours, and online voices and exploit them to develop predictive algorithms, improve their products and services, widen their reach, transcend geographical boundaries, and create opportunities for entrepreneurs to innovate. To measure performance and the effectiveness of digital business models, it is suggested companies go beyond traditional KPIs and instead establish digital traction metrics that consider industry specifics, describe the scale of their digital business, monitor the active usage and engagement of users on social media and other platforms, and track the momentum in market adoption of a product or service.[108]

Talent:

The composition of teams that work together to execute ideas and translate the strategy into action must have the right skills, talent and mindset. In a PwC report, skill shortage was cited by 73% of CEOs as a threat to their businesses, while 81% of them expressed interest in the broader mix of skills when hiring.[109] Digital transformation is already creating a range of new roles within organisations with their complementary skill set. Organisations must embrace this cultural transformation, make it visible at every level, and have it driven by the leadership team.

106 Network for Innovative Corporate Governance, 'Digital Transformation and Corporate Governance: Transparency, Traction and Talent as Key Ingredients', *Board Dynamics – Coping with Uncertainty. Actions for the Now and the Future*, 2021 (https://static1.squarespace.com/static/5c6bca3f0b77bde28679d229/t/6064e425e001e06be997a941/1617224741351/NICG_2021-1_Bronder_final.pdf)

107 World Economic Forum, 'Digital Enterprise', *World Economic Forum White Paper – Digital Transformation of Industries: In collaboration with Accenture*, p. 15

108 World Economic Forum, 'Digital Enterprise', *World Economic Forum White Paper – Digital Transformation of Industries: In collaboration with Accenture*, p. 36

109 Ibid, p. 27

In summary, a clear governance structure is needed to facilitate transparency and emphasise the need to refocus and reorient towards digitalisation.

Varoglu, Gokten and Ozdogan (2021) also consider how digitalisation impacts corporate governance practices. According to them, the four pillars that build effective corporate governance are fairness, transparency, accountability, and responsibility.[110] Fairness is upheld when a decision is taken duly and independently, thus ensuring inclusive protection, while *transparency* means the absence of hidden agendas or conditions. It is important to establish mechanisms and information systems to facilitate an effective conveyance of information to stakeholders to allow the interaction of fairness and transparency. The accounting process serves this purpose by converting data of the organisation's activities into meaningful information and reporting it. The board prepares an independent audit report safeguarded by the help of an audit committee and governance professionals to ensure transparency. Through this, the other principles of *responsibility* and *accountability* are maintained, ideally forming strong and effective corporate governance. However, financial accounting is no longer sufficient due to the demand for disclosure of non-financial information by stakeholders, including sustainability reporting on the environmental, social and economic impacts of the company's activities. Thus, there is a need for integrated reporting of financial and non-financial information. As integrated reporting has not yet been standardised, digital technologies can facilitate this integration and build a strong foundation of digital corporate governance.

5.5 The role of the boards in enabling digital transformation

Along with changing corporate governance comes the board's role in *enabling* digital transformation. An analysis by McKinsey & Company showed that boards still tend to consider technology adoption on the periphery or as a subtopic within their risk and audit committee.[111] Boards must prioritise technology engagement, moving corporate governance to e-governance as tasks are digitalised and operations increasingly run digitally. Boards should regard themselves as a catalyst for digital transformation when the nature of today's digital disruptions might necessitate long-term changes in the business model with high short-term costs.[112]They are the captains that guide the organisation in navigating technological waters. Boards should encourage executives to explore the power of the organisation's digital assets so that management can draw insights.

Furthermore, the digital age is leading to an evolution in decision-making in which decisions are no longer based on managerial instincts but are data-driven. Good tech governance may also foster a culture of innovation that is open and supportive of new strategies. In some cases, this might mean executives and board members must be digitally literate or establish a technology committee to support the organisation's technology strategy.[113] Likewise, governance professionals must be well-equipped with the digital knowledge and skills to provide supportive leadership to the board. The World Economic Forum suggests that CEOs move to an experimentation-oriented focus by using real-time data to guide the evaluation of the effectiveness of strategic initiatives[114]. The expertise of governance professionals may offer support in making that move.

Using artificial intelligence in different business processes allows algorithmic decision-making, saving time and lessening the need for managers' judgment. AI applications can assist decision-making by augmenting board intelligence to include the inputs and expectations of different stakeholder groups. This also benefits regulatory authorities as they reexamine regulations to eliminate loopholes. The effects of digital transformation on corporate law are also being evaluated. At the same time, some companies that have already implemented AI technologies have gone as far as giving it a seat on the board.

110 Varoglu, A., Gokten, S., Ozdogan, B., 'Chapter 10 Digital Corporate Governance: Inevitable Transformation' *Financial Ecosystem and Strategy in the Digital Era*, Springer, June 2021 (https://www.researchgate.net/publication/352386759_Digital_Corporate_Governance_Inevitable_Transformation)

111 Forrest, W., Li, S., Tamburro, I.,& Van Kuiken, S., 'How effective boards approach technology governance', McKinsey & Company, 15 September 2022 (https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/how-effective-boards-approach-technology-governance?stcr=A99BFB96D5084F59A2236F3453D5C2DE&cid=other-eml-alt-mip-mck&hlkid=d9223623b0dc4b75b69bf4e5cc38fc31&hctky=12118142&hdpid=261003f1-26ab-4f51-9c3a-c4774673e640)

112 Sarrazin, H., and Willmott, P., 'Adapting your board to the digital age', McKinsey & Company, 13 July 2016 (https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/adapting-your-board-to-the-digital-age)

113 Forrest, W., Li, S., Tamburro, I.,& Van Kuiken, S., 'How effective boards approach technology governance'

114 World Economic Forum, 'Digital Enterprise', *World Economic Forum White Paper – Digital Transformation of Industries: In collaboration with Accenture*, p. 21

On the other hand, one of the goals of emerging technologies is to speed up enterprise processes by eliminating intermediaries. These intermediaries could bring other methods, procedures or bureaucracies. A technological infrastructure that serves this purpose is blockchain technology which can work without intermediaries. Some scholars argue that a blockchain-based accounting and audit process can help audit committees implement more robust control and monitoring mechanisms. Furthermore, a blockchain infrastructure can house the company's ownership structure and voting processes. As a result, ownership records could be more transparent, investors could have enhanced mobility, and any possibility of insider trading actions could be monitored. Another application of blockchain technology is the use of smart contracts, which operate through a set of predetermined rules to automate transactions, save time and intermediary costs, and manage board and shareholder relations more effectively. This digitalisation process through blockchain can increase stakeholder participation in business decision-making, improve accountability for executives and potentially lead to a fairer corporate governance process.

Common challenges in technology adoption are material costs, labour costs, and talent recruitment, which are becoming harder to cover due to increasing competition. Boards should be prepared to use emerging technologies whether or not they are a technology firm. A BCG report found that the most innovative firms are not all technology firms but those that develop new platforms across their industry.[115] Hence, boards must be flexible, adaptable and more dynamic while working with governance professionals and technology committees to continuously improve their technological competence and capability in effective management, monitoring data, security and risk prevention, and business ecosystem leadership. Lastly, boards will have to go beyond the narrow focus on shareholders to include all stakeholders, strike a balance between the short-term and long-term, and develop a more evident higher purpose for the company.

Nonetheless, effective tech governance and management can turn digital transformation into the businesses' advantage. For instance, as emerging technologies enable companies to create a governance environment free from mediation, employees can then focus their time on upskilling and exercising creativity and innovation, enhancing their productivity and overall job performance. Technology now enables open and transparent communication between various stakeholder groups and better assessment of the risks threatening the company. Sustainability, and opens possibilities to design ways to drive this transformation in favour of the business.

Finally, in addition to the new roles highlighted above, as RegTech expands, corporate governance professionals may take on the part of additional tech compliance oversight. Companies are encouraged to adopt an electronic-GRC (eGRC) platform, which houses the regulatory obligations, compliance, events and controls applicable across an entity to maximise the organisation's control framework and facilitate consistency, transparency and efficiency across its three lines of defence.[116] An eGRC platform can help save costs via automated standardisation, controls rationalisation and integration of data sources for reporting and analysis, thereby reducing costs from processes and documentation. By integrating data into one platform, the senior management can have an aggregated dashboard overview provided by advanced analytics for enhanced visibility of risks and compliance obligations to facilitate transparency. Risk ownership and accountability can be promoted through electronic tagging to map incoming regulatory obligations to speed up the identification of the right control owners or correct processes. Lastly, an eGRC platform can help produce easily accessible, tailored, but customisable reports by using the platform's consolidated organisation information. Through this, the management can take advanced measures against potential cases of non-compliance and take action ahead. These are some benefits that GRC RegTech solutions can provide to financial institutions to assist them in managing risks and achieving compliance with regulatory obligations.

RegTech solutions may provide an efficient platform for financial institutions to improve governance and manage risk and compliance. However, there are key factors for consideration when adopting GRC RegTech solutions, including a clear vision, careful planning and

115 Torre, F., Teigland, R., and Engstam, L., 'AI leadership and the future of corporate governance – Changing demands for board competence', November 2019 (https://www.researchgate.net/publication/337203561_AI_leadership_and_the_future_of_corporate_governance)

116 Hong Kong Monetary Authority & KPMG, 'RegTech Adoption Practice Guide', *Issue #3: Governance, Risk and Compliance*, September 2021 (https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20210927e1a1.pdf)

assessment of the company's readiness. Companies should learn from the example of early adopters of RegTech solutions who have successfully utilised the technology to address their challenges. In September 2021, the Hong Kong Monetary Authority published a RegTech Adoption Practice Guide in collaboration with KPMG to guide and inform banks of the latest RegTech developments. The guide provides real-life RegTech cases as examples. In one example, external auditors told a bank of their lack of comprehensive centralised regulations record. This rendered them unable to identify the relevant rules and regulations and capture their obligations in their policies and procedures.[117] This was important to address because regulations come in huge volumes and frequently change, especially for global banks that have to comply with different jurisdictions, obey rules on cross-border activities, and may require experts that could appropriately translate regulations into obligations. This challenge cannot be overlooked, as regulatory non-compliance can lead to financial and reputational damage. To address this, the bank utilised a Cloud-based eGRC solution provider. It partnered with a regulatory horizon scanning data provider to give them access to the most updated regulatory changes issued by governments, regulators and third parties from different jurisdictions. The data provider curated reliable, professionally prepared regulatory summaries that filtered out irrelevant information, which the management tool housed together with the policies and procedures. As a result, the bank demonstrated consistent and value-based regulatory compliance with those in charge of governance. This required adequate time and planning to implement, as well as extensive research and cooperation with third parties to execute successfully. In another example, a financial institution used only standalone technology solutions with varying maturity levels, without any interface with other systems, which, as a result, did not provide sufficient holistic oversight. This lack of a centralised platform caused each business unit to have customised processes that had to be translated for a holistic level report, causing work duplication and inefficiency. To solve this, the bank appointed programme sponsors to evaluate the use of a GRC programme and review the bank's readiness for it. The programme identified a standardised format for each business unit to follow. The platform was then implemented after meeting the required standard after initial prototype testing. This case reinforces the need to dedicate adequate time for proper planning and preparation to complete a GRC transformation across the organisation, as numerous processes, procedures and parties are involved, as well as testing, risk assessments and guidelines to adhere to. Furthermore, there has to be a structured framework and governance model to oversee the implementation of RegTech-powered GRC transformation programmes. Corporate governance professionals can play an oversight role and serve as a link with the board in these cases.

As the Chartered Governance Institute of Australia points out, cybersecurity should be an organisation-wide concern rather than an issue left to information security officers and IT departments alone.[118] Boards must be cyber literate and prepared to acquire the cyber defence systems they need. While this could be a costly and time-consuming move, firms have to choose which costs they would instead cover – those associated with cyber protection and GRC programmes or those caused by reputational damage and cybercrimes.

5.6 Section conclusion

Technology advances have rendered digital transformation a necessity rather than an option. However, reaping the benefits of digital transformation requires a lot of work, particularly in transforming corporate governance, redefining the role of boards, rethinking strategy, and effectively acquiring and allocating resources. Digitalisation is a powerful tool to minimise information asymmetry and serve all stakeholders. Furthermore, there has to be equal importance in monitoring technological trends and considering and managing risks. While all of these take time, companies have no choice but to keep up with the pace of the changes to survive and thrive. Effective digital corporate governance, the competence and capabilities of the boards and management, and the extent to which companies and their leaders value

117 Hong Kong Monetary Authority & KPMG, 'RegTech Adoption Practice Guide'

118 Dane, C., 'Time to make cybersecurity a top priority for your board', *Chartered Governance Institute of Australia*, 12 October 2022 (https://www.governanceinstitute.com.au/news-media/news/2022/oct/time-to-make-cybersecurity-a-top-priority-for-your-board/)

their responsibility to all stakeholders will determine whether they thrive in the market.

Meanwhile, the developments in regulatory technology in managing risks and combatting fraud and cybercrimes and the increasing power and influence of social media and digital platforms cannot be overlooked. Cyber threats and challenges must be addressed from the boardroom, as failure to do so can tarnish the firm's reputation with potentially serious financial consequences. Firms have to choose which costs they would instead cover – those associated with cyber protection and GRC programmes or those caused by reputational damage and cybercrimes.

HIGHLIGHTS AND TAKEAWAYS:

Digital transformation has created value for companies by providing new revenue streams, enhancing efficiency, enabling the market expansion, and improving perceived valuation by investors. However, it has also opened new risks and challenges, such as outdated regulations, cultural transformation, changing stakeholder expectations, and tech governance.

Among the emerging technologies with accelerated adoption rates are the Internet of Things (IoT), Cloud and Data, AI and automation. Business leaders should take technological trends onboard when planning, executing and evaluating their strategies. Traditional corporate governance should be transformed into digital corporate governance by adopting digital business models and shifting to a culture of innovation. With good corporate governance that upholds the four pillars of fairness, transparency, accountability, and responsibility, companies can meet the key requisites of transparency, traction, and talent to achieve an effective digital transformation.

To maximise the benefits of technology, there is also a need for appropriate tech governance to ensure that the risks associated with implementing these technologies are controlled and minimised. Other factors, such as the influence brought by social media, must also be considered.

Full-board engagement is required to navigate tech-related issues, especially corporate strategy, operating models and governance.

RegTech solutions provide an efficient platform for financial institutions to improve governance and manage risk and compliance. However, its successful implementation relies on the company's readiness to adopt these solutions, careful planning, and continued support by the board towards digital transformation. The company secretary/governance professional should be the chief compliance officer in overseeing RegTech solutions if implemented in the company to ensure that the board is not only fully informed of its implementation but also held accountable for breaches in compliance.

Company secretaries/ governance professionals would be ideally placed to advise the board on digital transformation, general technological and other related risks, and assist in formulating plans. This can be enhanced by active participation with key stakeholders to appreciate technology's impact on the company's governance. Again, access, authority and resources to support the task are necessary.

Section 6:

Conclusion: Changing the role of the company secretary/ governance professional to establish governance leadership and status

> ***For the individual in the role, it is worth appreciating that the nature of the role itself then advances from simplicity towards greater complexity. As such, skills for dealing with ambiguity, the unknown, dilemmas and politics emerge as factors to leadership criteria.***
>
> ***(Authors)***

The issues identified in this report illustrate the many challenges that boards and company leadership face. To ensure their effectiveness in managing these significant issues, the company secretary/governance professional plays a key role. As the board's adviser on governance and regulatory matters, their contribution and responsibilities cannot be underestimated in ensuring that operations run smoothly and employees are informed about key developments in the company. Kakabadse et al.[119] argue that the role of a company secretary, encompassing technical, commercial and social characteristics, is 'highly effective.'[120] In this concluding chapter, we will add that by combining the necessity of change brought about by issues such as Covid, Climate change, Technology and other challenges, there is an opportunity to reimagine the role of the company secretary/governance professional, not only as a key governance professional but as a key player in the Boardroom makeup of the future.

Governance professionals should play a significant role in maintaining the highest standards. The role of company secretary/governance professional is seen as having formal responsibilities such as organising board meetings; providing support to the chairpersons/CEO and directors; dealing with governance issues and developments; assisting in the construct of annual reporting; statutory compliance issues; and numerous unspecified administrative duties. However, if we look beyond these 'technical' traits, the actual behaviours the company secretary/governance professional has to adopt also incorporate skills related to commercial capabilities and social characteristics. This includes helping resolve Boardroom clashes and dilemmas, acting as an aide de camp or advisor and/or confidante to the Chair and in relationships with the CEO, CFO, CIO etc. maintaining high levels of trust.[121]

As The Hong Kong Chartered Governance Institute observes, the company secretary/governance professional is the go-to person for the board, chairpersons and/or CEO for strategic advice on governance issues as a qualified professional whose business is to keep up to date with governance-related developments.[122] They manage the meeting process ensuring proper scheduling and conduct, circulating board documents and proposals, keeping and storing accurate records of meetings, and advising directors on legal and regulatory requirements.[123] They also manage compliance policies and procedures, ensure that company files, financial records and registers are kept up-to-date and prepared to comply with legal requirements, complete and file regulatory filings, frequently liaise with external advisers and stakeholders, and assist in training and development.

119 Kakabadse, A., Khan, N., & Kakabadse, N. K. (2016). Company secretary: a role of breadth and majesty. *Society and Business Review*, 11(3), 333-349.
120 Kakabadse, A., Khan, N., & Kakabadse, N. K. (2016). Company secretary: a role of breadth and majesty. *Society and Business Review*, 11(3), p343.
121 Kakabadse, A., Khan, N. and Kakabadse, N. (2017) Leadership on the board: the role of company secretary. In: Storey, J., Hartley, J., Denis, J.-L., t' Hart, P. and Ulrich, D. (eds.) The Routledge Companion to Leadership. Routledge, Abingdon, pp. 241-259. ISBN 9781138825574 Available at https://centaur.reading.ac.uk/68907/
122 Global review of the role of the company secretary. (2021). Governance Directions, 73(1), 10–14.
123 Tricor Hong Kong, 'Evolving Role form Company Secretary', *HSBC VisionGo*, 9 June 2022 (https://www.businessgo.hsbc.com/zh-Hant/article/evolving-role-from-company-secretary-)

Governance professionals ensure that directors are well-informed and consider critical processes to manage business continuity risks and succession planning. The need to oversee recent developments related to geopolitical and global economic risks, ESG adoption, digital transformation and RegTech have added considerably to these duties. Given their increasing role in shaping governance, risk, and compliance, governance professionals are, in effect, undertaking a senior leadership role.

Digitalisation in the last five years has changed the way business is conducted. One example is video conferencing, in which people can communicate via real-time video despite being in different geographical locations and time zones. Following the government's pandemic measures, this has been incredibly useful and instrumental in allowing board meetings to continue, especially in conducting annual general meetings (AGMs), including voting through technology. During virtual board meetings, it is necessary to ensure sufficient security and proper identification procedures to safeguard the forum's integrity and that recordings are available and stored correctly. While these challenges tested the skills and capabilities of governance professionals, they also showcased their extreme adaptability and expertise and displayed their professional leadership and stewardship. From administering new remote working models to facilitating the flow of communication in board meetings by implementing new technological systems, company secretaries have been pivotal in ensuring continual operations and assisting the board in performing their necessary functions. This is only one of the new issues that company secretaries must deal with.

Company secretaries need to evaluate the effectiveness of risk management and review the company's risk profile. They must anticipate potential scenarios that may put the company at risk. While naive shareholders may perceive the board's regular risk assessments as a mere procedural practice to comply with stock exchange requirements, it is essential in building the company's preparedness. The process allows the organisation to identify threats and their consequences to the company's financials, operations, and management capacity. At the writing of this report, the Silicon Valley Bank in the U.S. collapsed. And Credit Suisse was forced to be taken over by UBS by the Swiss government. Again, the question of the board's risk management was raised by commentators.[124] Therefore the company secretary/ governance professional's role in risk management would only grow given the multiplicity of economic, business, geopolitical, and other factors raised in the report.

Governance professionals must keep up-to-date with key developments to address change challenges. In addition to being board advisers, upholders of good corporate governance and liaison with stakeholders and relevant external parties (such as investors, accountants and regulators), company secretaries should work to optimise the use of digital channels for communication and the acquisition and dissemination of information. Through this, they can assist the board in making timely and informed decisions and preparing for potential challenges should similar disruptive events happen.

A survey conducted by the Hong Kong Institute for Monetary and Financial Research suggested the likelihood of working-from-home arrangements for 25% of financial service staff over the next five years and increased customer receptiveness to using new technology.[125] Digital channels are expected to take on a more prominent role due to the digitalisation of financial services. The survey also revealed that most financial institutions support supervisory guidelines and value the importance of public-private partnerships and knowledge sharing to establish data infrastructure for financial institutions and the digitalisation of financial services across the industry. Regulators will have to check the effectiveness of hybrid work models and ensure the resilience of financial institutions towards cyberattacks and data breaches. This amplifies the governance professionals' role as they serve as the communication channel between regulators and the board while navigating these unprecedented challenges.

124 Barsky, N.., 'Silicon Valley Bank Proxy Shows Board's Secret Yearlong Risk Panic', *Forbes*, (https://www.forbes.com/sites/noahbarsky/2023/03/12/silicon-valley-bank-proxy-shows-boards-secret-yearlong-risk-panic/?sh=22daccd21e7b)

125 Hong Kong Institute for Monetary and Financial Research, 'COVID-19 and the Operational Resilience of Hong Kong's Financial Services Industry', *HKIMR Applied Research Report No.2/2022*, June 2022 (https://www.aof.org.hk/docs/default-source/hkimr/applied-research-report/covid19rep.pdf)

6.1 Getting beyond the technical to the issue of informal power

The company secretary/governance professional position might be overlooked as administrative only.[126] However, they deliver on strategic leadership, add significant value as a vital go-between, and help facilitate the successful delivery of organisational objectives.' [127] This more strategic set of behaviours would offer the opportunity to re-envision the evolving role of the governance professional.

With the degree of change taking place, it is unlikely that, for typical boards, their structure, functions and ways of working have changed at anything like the pace of the organisations they lead or the world in which they operate. For example, all organisations are increasingly held to account by public opinion, as expressed through social media and other channels. The timeframe over which a problem becomes a crisis is now measured in hours and minutes rather than weeks and days, and boards have to become more responsive and nimbler. Similarly, technology will continue to have many positive benefits in how boards function. It can enhance decision-making by enabling deeper and faster analyses to be carried out and facilitating shareholder and stakeholder engagement.

Size matters! Most company secretaries/governance professionals commonly refer to their responsibilities within three broad categories; reporting, governance and board process. In smaller organisations, the company secretary/governance professional is primarily concerned with reporting; those in medium size operations emphasise governance factors, and company secretaries/governance professionals in large organisations prioritise board processes to build their discretionary capacity.[128] This is set to change. In the UK, for example, nearly two-thirds of the Chartered Governance Institute's members expect further reductions in the time spent on administrative tasks previously carried out manually, freeing up their capacity to undertake activities that arguably generate greater value for the board and organisation.[129]

The role of the company secretary as governance professional should include the authority and autonomy to secure information and demand cooperation from different groups without constantly having to request approval. They can provide proper advice and other services to the board as required by the corporate governance code.[130] In the event of crises, governance professionals have proven themselves capable. Their role is crucial in maintaining the company's strength and resilience to thrive during disruption and unprecedented challenges.

Another theme picked up repeatedly in this report is that the role of a company secretary/governance professional is part of senior management. This necessitates more formal authority, more resources, and the granting of more access to undertake the role and support the board's leadership. Such need should not be *ad hoc* or highly dependent on each board as risk management and being a strategic leader is no longer occasional or contingent on certain events.

6.2 Recommendations

There is a necessity in Hong Kong to enhance the standing and reputation of the company secretary/governance professional.

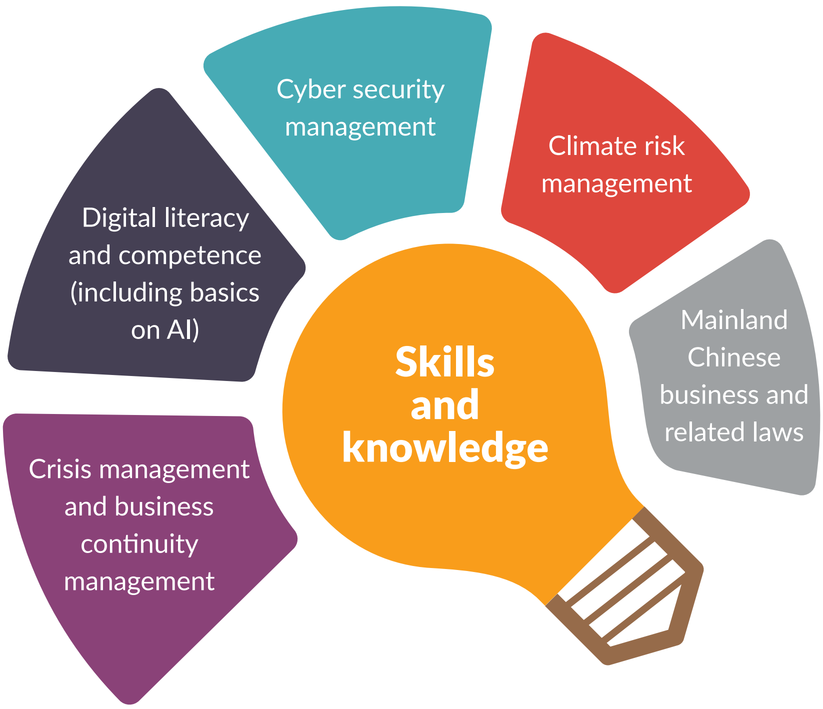
Our first recommendation is that re-titling this role to Chief Governance Officer (CGO) will lift the level of professionalism, public standing, and broader business community respect. The Listing Rule 2A.09 already provides that the company secretary of this listed issuer is part of the senior management of listed issuers. It is necessary to use this idea to promote the company secretary/governance professional position. Thus, a company secretary/governance professional in this light is responsible for offering governance advice

126 Nowland, J., Chapple, L. and Johnston, J. (2021), The role of the company secretary in facilitating board effectiveness: reporting and compliance. Account Finance, 61: 1425-1456. https://doi.org/10.1111/acfi.12632
127 Kakabadse, A., Korac-Kakabadse, N., Khan, N., Morais, F., & Lee-Kelly, E. (2014). The company secretary: building trust through governance.
128 Kakabadse, A., Korac-Kakabadse, N., Khan, N., Morais, F., & Lee-Kelly, E. (2014). The company secretary: building trust through governance.
129 'Next Generation Governance'; ICSA: The Governance Institute; 2018
130 HKEX, 'Consultation Conclusions on the Review of Corporate Governance Code & Related Listing Rules, and Housekeeping Rule Amendments', C.6.4, December 2021 (https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/April-2021-Review-of-CG-Code-and-LR/Conclusions-(Dec-2021)/cp202104cc.pdf)

to the board, similar to a CEO or CFO.[131] Combined with existing duties in listing rules compliance and being a trusted advisor to the board, a company secretary/governance professional role could be acknowledged, and the position given relevant powers by the board to establish it at the senior executive level.

The CGO's responsibility could include risk management if the company does not have a Chief Risk Officer or Director of Risk. Even if the Chief Financial Officer is responsible for financial risk, with risks associated with ESG/climate change, digital transformation, and a crisis prompted by Covid or geopolitics, monitoring and responding to these non-financial risks are critical a company's performance and even survival. Another function the CGO could undertake is to be head of compliance. One of the key responsibilities of a company secretary/governance professional for listed entities is to take the lead in compliance with listing rules, plus a miscellaneous number of compliance obligations. Taking on the head of compliance would be organic growth. Besides, having a CGO with compliance responsibilities in the boardroom would be beneficial in monitoring compliance risk at the board level. Since there are no set rules for who the compliance department reports, many companies have different arrangements. As such, a CGO could easily step into this role.[132] Moreover, compliance obligations are expected to increase, especially for companies in Hong Kong or those listed on the HKEX dealing with a complicated maze of Mainland laws and provincial rules in the GBA on the one hand, and on the other hand, a large number of laws from various foreign jurisdictions around the world arising from trade in goods and services including sensitive matters like sanctions.

Our final recommendation is to explore the continuous training of company secretaries and governance professionals. This report has covered many challenges, and there is a clear need for company secretaries/governance professionals to upskill further. These skills and knowledge building blocks could cover the following:



The changing role of the company secretary/governance professional requires more continuous training beyond CPD. A company secretary's/governance professional's job has evolved organically and out of necessity. The forward-looking challenges shall be more dawning than in the past. Since the international qualifying scheme is recognised as a postgraduate Master's degree, it may be logical to scale this with other intellectual rigour. A Doctor of Business Administration (DBA) in Governance, Risk and Compliance would make sense.

In conclusion, nothing stays the same for long. In terms of the company secretary/governance professional, the role, the job, and the profession will have to step up to meet these challenges armed with more insight, skill and capability, and, one might suggest, reputation.

131 Ibid., 1003-5.

132 For more discussions about who the compliance department reports to see Young, A. and Seidenfuss, K. (2023) A Concise Guide to Corporate Compliance Management, *2nd edition*, Hong Kong, Wolters Kluwer

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The Hong Kong Chartered Governance Institute (HKCGI), formerly known as The Hong Kong Institute of Chartered Secretaries (HKICS), is the only qualifying institution in Hong Kong and Mainland China for the internationally recognised Chartered Secretary and Chartered Governance Professional qualifications.

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