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**Article**

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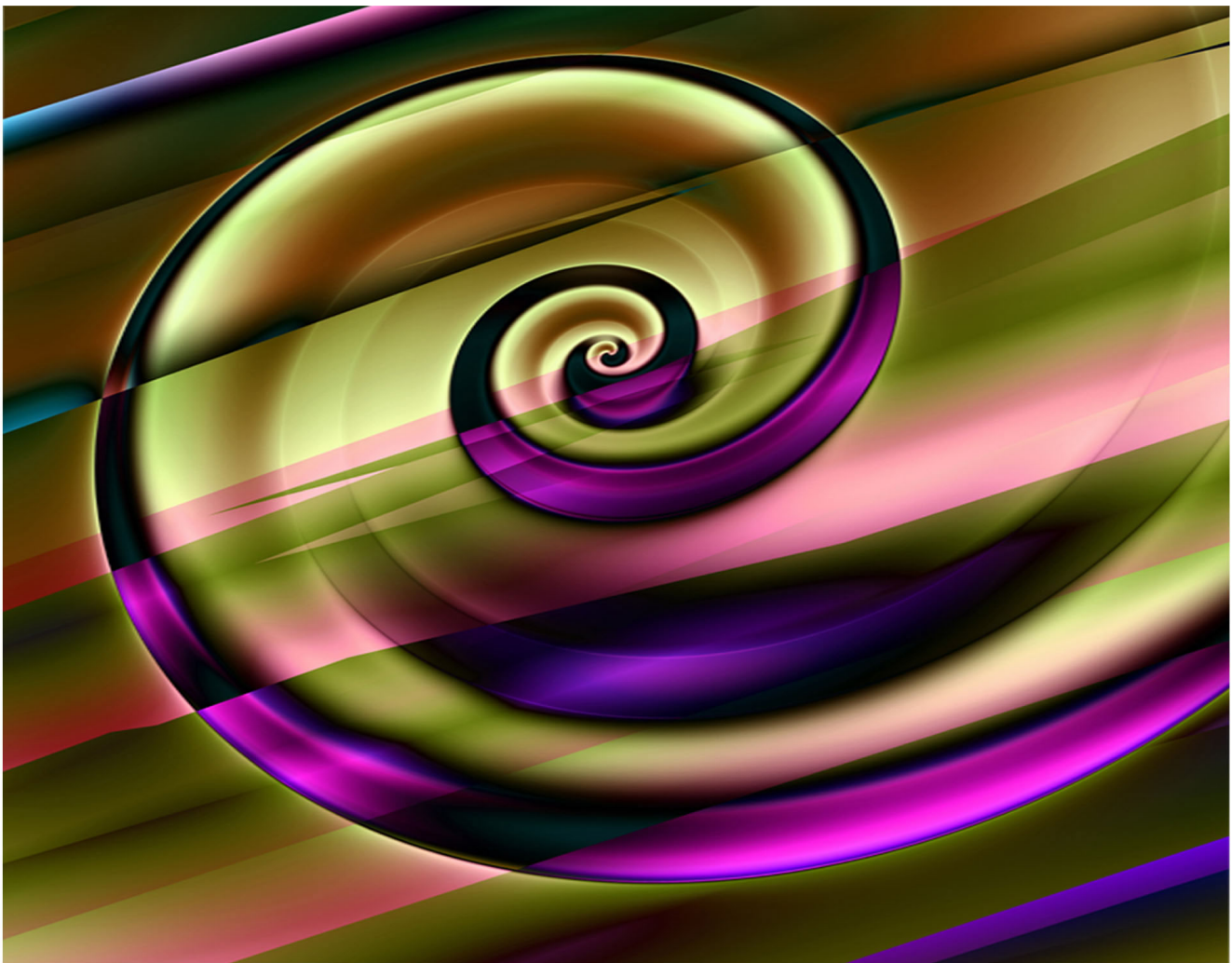
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## **BANKING SECTOR GOVERNANCE - LESSONS FROM HONG KONG LISTED BANKS- A THREE YEAR PERSPECTIVE ANALYSIS.**

**SH.D.CHATTERJEE\***

### **Abstract**

*Hong Kong's financial sector is popular within the banking industry for the range of service providers themselves. Using the case study approach, this paper explores the changes to the boards of directors and governance issues of the 12 listed banks on Hong Kong stock exchange over a three year period. It focuses on issues such as the number of directors on the boards, their qualifications, type of directors in terms of independence, outside directorships held, and the auditors of the financial statements from 2004 to 2006. Through the use of archival data over a three year period, this paper finds that the overall listed banks in Hong Kong exhibit good corporate governance, and that this governance has in fact improved in quality over the years. The three year comparison demonstrates that the high level of corporate governance exhibited by the 12 listed banks in Hong Kong from 2004 to 2006 provides a possible explanation to the success of the region a significant international financial center due to the factors such as absence of duality of CEO and chairman, use of the Big four audit firms, qualifications of directors, and use of independent non-executive directors on the boards. According to Stan wick and Stan wick (2005), the long-term survival of banks is dependent on the success of the boards of directors, as they are the ultimate decision-making bodies of the organizations (Psaros and Seamer, 2002).*

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\* Research Scholar, Department of management, BIT, Mesra, Ranchi, Jharkhand.



## INTRODUCTION

### Structure of the Hong-Kong Banking system

Hong Kong is an important international financial center, and one way in which it can maintain an orderly commercial environment is through corporate governance. In view of the special roles that banks play in economies, it is especially prudent that listed banks demonstrate good corporate governance to enhance the business setting. This paper explores the current corporate governance initiatives in the backdrop of the Stock Exchange of Hong Kong (2004), over a three-year period, i.e., 2004-when the code was just a draft; 2005-when it became law in 2005; and 2006-the first year of its implementation.

The Hong Kong Monetary authority as of February 2006, reported that there were 137 Licensed Banks, 30 Restricted Licensed Banks, 32 Deposit-Taking companies and 85 Representative Offices of Foreign Banks. For the quarter ended September 2006, banks employed 81,619 persons in Hong Kong. The Hong Kong Trade Development Council (HKTDC, 2007) reported that 76 of the world banks exist in Hong Kong and that it is the second largest loan syndication center in Asia and Asia's third largest international banking sector.

Hong Kong is now the sixth largest foreign exchange center, and is known for its 'high standards of market transparency, disclosure and prudently supervised financial institutions' (HKTDC 2007, P.1). These statistics confirm the importance of Hong Kong as a financial center and the importance of its banking industry.

In summary, restoration of market confidence requires demonstrable and demonstrated integrity in business, the professions, regulators and governments. In particular we require:

- High quality, transparent making and requiring an effective Audit Committee or equivalent, comprised of independent directors.
- Governments, companies and professionals must be tough on fraud and tough on the causes of fraud
- Confidence depends on having high quality directors and auditors. They will not be there if there is a fair liability regime giving a proper balance of risks and rewards
- None of this has any value without high quality enforcement. This requires consistency and co-operation amongst professional bodies, market regulators and governments.

## REVIEW OF LITERATURE

### Corporate Governance

Large corporate collapses of the past 20 years, from the Australian experience of Bond Corp., Health International Holidays Insurance Ltd.(HIH), OneTel and Harris Scarfe to the American experiences of Enron and WorldCom), have led to an increasing focus on corporate governance in management literature and business research. Most of the debate has been in the agency framework and pursuing the idea that governance regimes had the primary task of discouraging opportunistic managerial behavior. The collapse of such large corporations with seemingly little notice has unsettled investors, government, government, and management and reduced confidence in the financial markets. In response, the governments and their regulatory agencies keen to restore confidence have been jolted into knee-jerk reactions, including embarking on specification of corporate governance practices for large listed corporations (Clifford and Evans, 1996).

These practices are generally supported by government legislation and made compulsory by the listing rules of stock exchanges worldwide. The international bodies such as the International Monetary Fund (IMF, 2003) and the Organisation of Economic Cooperation and Development (OECD, 2004) too have extended the formal recognition to corporate governance.

The pervading themes in many corporate governance regimes relate to the composition and independence of board of directors, auditor and audit committee independence, and appointment and remuneration committees, each with a view to protecting the interests of absentee shareholders. Underlying these concerns is the idea that questionable agency relationships arising from the perceived separation between ownership and control threaten shareholders' interests (Jensen and Meckling 1976).

'Gubernare' and 'gubernator', the roots of 'governance', refer to the steering of a ship (Farrar, 2001. by analogy, this steersmanship is aligned to the methods of ethically controlling and directing the affairs of corporate entities. In the contemporary corporate setting the Latin steersmanship notion of an entity is akin got he idea of matters being shipshape.

The issue of business governance dates back to as far as 1800 BC with the code of Hammurabi, (Werhane, 2000) that controlled the ethics of traders and merchants. Fathers of modern economic doctrine such as smith (1776) and Spencer (1862) contributed to the current understanding of

corporate governance by defining the links between ethics and economics which encourage management to become accountable for its actions through the use of standardized preparation of accounts and auditing that satisfies the users (especially shareholders).

Williston (1908) describes the modern corporation evolving from a relationship between government and industry and surviving through a combination of capital and mutual cooperation. The advent of the corporation of the 1800s and its increase in size and importance were crucial to infrastructure development, and as such to societal good. This reasoning extended by Carlos and Nicholas (1988) included the advent of multinational corporations through the 19<sup>th</sup> century developing from the experience and use of domestic and cross-border level production facilities. The UK companies' act of 1844 was a mechanism of corporate governance construed to facilitate the separation of ownership and control and to make managers accountable to the shareholders. This move made the investment in joint stock companies an acceptable risk.

Table 1 compares the dominant mechanism in seven international corporate governance regimes—the OECD (2004), the Sarbanes Oxley Act (SOX, 2002) the combined code of UK (CCUK, 2003), the New Zealand principles and guidelines (NZ CG, 2004) the Australian securities exchanges good corporate governance and best practice principles (ASXGCG, 2003), the Hong Kong Code on corporate governance practices (HK CGP, 2004) and the Swedish code for corporate governance (SCCG, 2005).

Table 1: Comparison of codes							
Principles	OECD 2004	SOX 2002	CCUK 2003	NZ CG 2004	ASXGCG 2003	HK CGP 2004	SCCG 2005
governance framework		x	x	x		-	-
SH rights							
SH treatment					-	-	
Stakeholder treatment							
Auditor independence							
Integrity of reports							
Timely reporting							
Board responsibility							
Board to add value		X					
Ethical decisions	X	X	X			-	-

Risk management	X	X	x			-	-
remuneration	x	x					

Table 1 show that each of the regimes is a set of protective principles designed to protect the interests of absence shareholders. It shows a variety of combinations and lack of consistency in designing and applying corporate governance initiatives.

These comparisons show a variation in what is considered the applicable corporate governance mechanisms in different countries and for different organizations. It is interesting to note that SOX appears to be centered on penalties to prevent fraud, whereas the ASXGCG and NZ CG are the only organizations to mention risk and ethics. This is more likely a reflection of the current differences in the amount of litigation occurring in the US, and the Australian and New Zealand attempts to prevent litigation by introducing risk management and ethics.

It is also noted that the Hong Kong governance principles fail to mention a corporate governance framework and fail to specifically address the stakeholders they mainly focus on board composition and responsibilities. It is in this light that we address the way in which listed banks in Hong Kong have changed (if any) the composition and qualifications and auditors of the banks over the three-year period to improve and implement the new governance regimes.

### **Money laundering**

Alongside liberalization of the Yuan market, the Hong Kong Monetary Authority (HKMA) has urged banks in the jurisdiction to be alert to the possibility of money laundering as they gear up to offer Yuan denominated banking services. "Participating banks are requested to heighten the awareness of their staff involved in such business to possible money laundering transactions," the regulator announced. In order to reduce the possibility of money laundering activity taking place, the HKMA ordered banks to record whether Yuan deposits are made in cash, or via the conversion of other currencies.

It also urged the financial institutions to keep tracks of multiple accounts opened by the same customer, and to ensure that the 20,000 Yuan per day exchange limit is not breached by spreading the transactions across several accounts.

On this front, the Hong Kong Securities and Futures Commission (SFC) entered into a MoU with the CBRC for co-operation and information sharing with respect to Hong Kong licensed intermediaries who provide service to mainland commercial banks conducting overseas wealth

management business on behalf of their clients.

The MoU was signed on April 10, 2007, in Hong Kong by Eddy Fong, Chairman of the SFC and Liu Mingkang, Chairman of the CBRC and took immediate effect. “The MoU is conducive to further enhancement of the regulatory co-operation framework. It provides a solid foundation for the commencement of effective regulatory co-operation,” stated Liu. “Through mutual assistance and information sharing, we can promptly identify risks, and take timely regulatory measures to protect the interests of investors.”

Agents and money changers must also record and retain the particulars of the sender and the instructor of any transaction if the two are not the same person.

## **DIRECTORS’ DUTIES IN HONG KONG**

The term ‘director’ is defined in Section 2 of the companies’ ordinance as to include ‘any person occupying the position of director by whatever name called’. Persons who purport to act as a company director in Hong Kong will therefore be regarded as a director under Hong Kong law. Whether or not designated or otherwise described as a company director. Directors must comply with the obligations imposed on them by statutes such as the companies ordinance, non-statutory requirements including those contained in the rules governing the listing of securities on the stock exchange of Hong Kong Limited 1989 (the ‘Listing Rules’), the company’s articles of association, and their contracts with the company.

Company directors and senior employees to whom the board of directors has delegated managerial duties have a fiduciary relationship with the company (green vs. bestobell industries ltd.). In its principles of corporate governance, the American law institute (1984) refers to the directors’ duty of loyalty and the duty of care, otherwise known as fiduciary duties and the duty of care and skill. Derived for Roman law, the term ‘fiduciary’ is used to describe a person who has the character of or similar to that of a trustee and who is obliged to act solely for that person’s benefit (Martin, 1997).

## **CORPORATE GOVERNANCE IN LISTED BANKS IN HONG KONG**

In this study it is proposed to investigate five areas of interest to see if the composition has

changed over the three-year period in which the corporate governance listing rules were introduced. The areas are:

- 1) The mixture of executive and independent non-executive directors: Has this changed over the three years to include more independent non-executive directors? (Recommended by ASXGCG, 2003 and HK CGP, 2004).
- 2) Companies with duality of chairman and CEO: Has this changed overtime? (Separation of the roles is recommended to enhance corporate governance by ASXGCG, 2003 and CGP, 2004).
- 3) Education of directors: Has this improved over time in terms of masters and doctorate degrees (Tsui and Gul, 2000) to add value to the board?
- 4) Experience: Are directors increasing their experience overtime by taking on new board roles?
- 5) Big four auditors: Have they changed over the three-year period, if so why?

The mixture of these five areas was called banking sector governance by Barnes and Lau (2007), and they are also areas that form part of director governance (Barnes and Kwan, 2006). Based on the underlying literature, the research question is: Have the corporate governance practices of the 12 listed banks in Hong Kong improved over time, especially after the new listing rules were introduced for the financial year ended 2005?

## **THE METHOD OF INQUIRY**

Archival data was collected from publicly available sources, such as company websites and annual reports of the 12 stock exchange of Hong Kong (SEHK) listed banks. Using case study method, the information gathered was used to determine whether there is separation of roles between chairman and CEO; and to determine the number of independent non-executive directors of the banks, the directors' backgrounds and qualifications and details related to the auditor.

Data relating to the Hong Kong listed banks, which were collected from the above sources are assumed accurate as the disclosures are required under the SEHK listing rules.

### **The regulatory framework and rules (SEHK, 2007) notes:**

The principal function of the exchange is to provide a fair, orderly and efficient market for the trading of securities. In furtherance of this, the exchange has made the exchange listing rules

under section 23 of the securities and futures ordinance prescribing the requirements for the listing of securities on the exchange.

The Hong Kong exchanges and clearing limited (HKEx), which is the holding company of SEHK has now issued a corporate governance practices code (2004), and this became compulsory on January 1, 2005 for all listed companies on the SEHK (Lau and Lam, 2006). Modeled on the combined code of the UK (2003) it is an ‘if not, why not’ explanation of any deviation in the prescribed corporate governance practices.

### **Data Analysis and Results**

The data collected were based on an initial study by Barnes and Kwan (2006), which was limited to 2004 and did not contain any auditor information. This study primarily looks at five areas of interest of banking sector governance (Tables 2-9).

The data indicate that three of the 12 banks do have the chairman and director to be the same person, i.e., 75% of banks do have separation of the roles. The data also demonstrates that during the 2005 year of implementation the Wing Lung Bank Ltd. Decided to change the duality role of its CEO and chairman (Table 2).

Table 2: Duality of chairman and CEO			
Listed bank	2004	2005	2006
Asia financial holdings	Separate	separate	Separate
BOC Hong Kong (Holdings) Ltd.	Separate	Separate	Separate
The bank of east Asia ltd.	Duality	Duality	Duality
Dahl sing financial holdings ltd.	Separate	Separate	Separate
Futon bank (Hong Kong) ltd.	Separate	Separate	Separate
Hang Seng bank	Separate	Separate	Separate
HSBC Holdings plc.	Separate	Separate	Separate
Industrial and commercial bank of China (Asia) ltd.	Separate	Separate	Separate
Liu Chong Hing Bank ltd.	Separate	Separate	Separate

Standard Chartered plc.	Separate	Separate	Separate
Wing Hang Bank	Duality	Duality	Duality
Wing Lung Bank Ltd.	duality	Change during the year	separate

Table 3: Number of independent non-executive directors 2004

Number of directors on board independent vs. executive	Total directors 2004	Independent non-executive directors 2004	Independent 2004 (%)
Asia financial holdings	18	3	17
BOC Hong Kong (Holdings) Ltd.	11	4	36
The bank of east Asia Ltd.	15	6	40
Dah sing financial holdings Ltd.	16	4	25
Fubon bank (Hong Kong) Ltd.	10	3	30
Hang Seng bank	15	8	53
HSBC holdings plc.	22	13	59
Industrial and commercial bank of china (Asia) Ltd.	10	3	30
Liu Chong Hing bank Ltd.	20	3	15
Standard chartered plc.	16	9	56
Wing Hang bank	12	5	42
Wing Lung Bank Ltd.	13	5	38

Table 4: Number of independent non-executive directors 2005

Number of directors on board vs. executive independent	Total directors 2005	Independent non-executive directors 2005	Independent 2005 (%)
Asia financial holdings	18	3	17
BOC Hong Kong Ltd.	13	6	46
The bank of east Asia Ltd.	17	7	41
Dah sing financial holding Ltd.	16	4	25
Fubon bank Ltd.	10	3	30
Hang Seng bank	15	8	53



HSBC holdings plc.	20	13	65
Industrial and commercial bank of china (Asia) ltd.	10	3	30
Liu Chong Hing bank ltd.	19	3	16
Standard chartered plc.	15	9	60
Wing hang bank	12	5	42
Wing Lung bank ltd.	13	4	31

Table 5: Number of independent non-executive directors 2006			
Number of directors on board independent vs. executive	Total directors 2006	Independent non-executive directors 2006	Independent 2006 (%)
Asia financial holdings	17	3	18
BOC Hong Kong ltd.	13	6	46
The bank of east Asia ltd.	17	7	41
Dah sing financial holdings ltd.	17	4	24
Fubon bank ltd.	10	3	30
Hang seng bank	15	8	53
HSBC holdings plc	18	13	72
Industrial and commercial bank of china ltd.	10	3	30
Liu Chong Hing bank ltd.	19	3	16
Standard chartered plc.	13	8	62
Wing hang bank	11	5	45
Wing lung bank ltd.	13	4	31

Table 6: Change in independent directors over time				
Number of directors on board in independent vs. executive	Independent directors 2004 (%)	Independent directors 2005 (%)	Independent directors 2006 (%)	Increase or decrease over time 2004-2006 (%)
Asia financial holdings	17	17	18	>1
BOC hong kong ltd.	36	46	46	>10
The bank of east Asia ltd.	40	41	41	>1

Dah sing financial holding ltd.	25	25	24	<1
Fubon bank ltd.	30	30	30	No change
Hang seng bank	53	53	53	No change
HSCB holdings plc.	59	65	72	>13
Industrial and commercial bank of china ltd.	30	30	30	No change
Liu chong hing bank ltd.	15	16	16	>1
Standard chartered plc.	56	60	62	>6
Wing hang bank	42	42	45	>3
Wing lung bank ltd.	38	31	31	<7

It must be noted that standard chartered did not indicated the academic qualification of its directors (Table 7).

Table 7: Qualification of directors in terms of masters or doctorate degrees								
Highest degree professional qualification held	2004 MA	2004 DR	2005 MA	2005 DR	2006 MA	2006 DR	Change MA	Change DR
Asia financial holdings	1	3	1	3	1	3	none	None
BOC hong kong ltd.	7	2	8	2	8	2	>1	None
The bank of east Asia ltd.	4	7	5	7	6	6	>2	<1
Dah sing financial holding ltd.	0	1	0	1	0	1	None	None
Fubon bank ltd.	9	0	9	0	10	0	>1	None
Hang seng bank	1	5	1	5	1	5	None	None
HSBC holdings plc.	1	0	1	0	1	0	None	None
Industrial and commercial bank of China (Asia) ltd.	7	2	7	2	7	2	None	None
Liu chong hing bank ltd.	10	1	8	3	8	3	<2	>2
Standard chartered plc.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Wing hang bank	2	3	3	3	2	3	None	None

Table 8: Other directorships held							
Other directorships held	No. 2004	Total 2004(%)	No. 2005	Total 2005(%)	No. 2006	Total 2006(%)	Change 2004-2006
Asia financial holdings	17	94	17	94	17	100	None
BOC hong kong ltd.	11	100	13	100	13	100	>2
The bank of east Asia ltd.	13	87	15	88	15	88	>2
Dah sing financial holdings ltd	13	81	13	81	14	82	>1
Fubon bank ltd.	5	50	5	50	4	40	<1
Hang seng bank	15	100	14	93	15	100	None
HSBC holding plc.	21	95	19	95	18	100	<3
Industrial and commercial bank of china ltd.	7	70	7	70	7	70	None
Liu chong hing bank ltd.	10	50	10	53	10	53	None
Standard chartered plc.	12	75	13	87	12	92	None
Wing hang bank	9	75	9	75	8	67	<1
Wing lung bank ltd.	13	100	12	92	12	92	<1

It appears that the majority of directors hold other directorships either in subsidiaries or other corporations (Table 8).

The results show that all the listed banks are audited by one of the Big Four auditors. Except one bank, i.e., Industrial and Commercial bank of China (Asia) Ltd. Others retained the same auditor for the three years of analysis from 2004 to 2006 (Table 9)

## DISCUSSION

### Duality of roles of CEO and Chairman

Traditional financial information has focused on statements of profit: assets and liabilities; and cash flow. Research by price water house coopers, however has shown that investors, analysts and company directors and management all believe that better disclosure can have

significant

benefit for both companies and those with a stake in them. Achieving proper transparency requires management to confront five major challenges:

- Model external reporting on internal reporting
- Determine the information that stakeholder need
- Report relevant information from external sources
- Report on the real economic entity
- Weigh the risks and costs against the benefits

Such an approach enables information gaps that are the gulf between the information provided by management and the information which users require, to be filled. Examples of such gaps are in the areas of market growth, market share, corporate strategy, segment information, product innovation, customers and quality of management. The provision of information to fill the gaps has been christened “value reporting” by price water house coopers.

Relevance can also be enhanced by making information available to users in a way which enables them to formulate it in the format which they themselves find most useful. One example is for companies to give information on the internet using powerful new financial reporting technologies such as Extensible Business Reporting Language (XBRL).

Relevance and transparency also require unbiased objectivity. This matter has been highlighted by the Auditing Practices Board (APB) in the UK which issued its Consultation Paper “Aggressive Earnings Management” in June of last year because it was concerned that, despite the progress made during the last decade in Corporate Governance/ Accounting Standards and Auditing Standards, the quality and reliability of financial reporting may be undermined by increasing financial pressures on those responsible for preparing financial statements. This consultation paper was warmly welcomed by commentators. The APB’s consultation paper “Priorities and Future Work Programme” published last week puts aggressive earnings management at the top of the agenda. It plans to:

- Update, in conjunction with IAASB, auditing standards on fraud, materiality and the audit of accounting estimates
- Review the impact of its new standard on communication with those charged with

corporate Governance (SAS 610) and issue guidance for audit committees on the implications of SAS610

- Review other standards including those relating to related parties and quality control and assess whether they are sufficiently robust
- Urge the accountancy bodies and accountancy firms to give increased emphasis to the need for professional skepticism and underpin auditing standards with post qualification training.

It appears that only three companies initially had duality of roles: this could be because they are family companies, which are usually run by the family, owning 20% of the shares and occupying two positions on the board (Barnes and Lau, 2007). Millstein (1992) recommends separation of the roles as otherwise it will erode board independence and can lead to CEO dominance. This is also supported by the Australian stock exchange governance rules (2003) and the UK Cadbury committee (1992).

Table 9: Auditors of the listed banks in Hong Kong

Auditors	2004	2005	2006
Asia financial holdings	Erst & Young	Erst & young	Erst & yonng
BOC Hong Kong ltd.	PWC	PWC	[WC
The bank of east asia ltd.	KPMG	KPMG	KPMG
Dah sign financial holdings ltd.	PWC	PWC	PWC
Fubon bank ltd.	KPMG	KPMG	KPMG
Hang seng bank	KPMG	KPMG	KPMG
HSBC holding plc.	KPMG	KPMG	KPMG
Industrial and commercial bank of china	PWC	PWC	Erst & young
Liu chong hing bank ltd.	Deloitte TT	Deloitte TT	Deloitte TT
Standard chartered plc.	KPMG	KPMG	KPMG
Wing hang bank	KPMG	KPMG	KPMG
Wing lung bank ltd.	PWC	PWC	PWC

### On the roles of boards that affect Governance

to further the boards role on the Governance of the listed banks in Hong Kong, the following

are prescribed especially if former executives hold the seats:

- Financial reporting based on a robust and stable three legged stool of financial reporting standards, standards of auditing and ethical guidance founded on a solid bedrock of enforcement
- Standards and guidance should be based on clear principles, not on detailed rules
- Standards should be international and should be set by international bodies
- Company reports should be clear and focus on the main messages. Additional detail can be provided through the internet, including the use of xbrl

principles of good Governance should be established on an international basis by the business community. These should include ensuring that no single individual has unfettered powers of decision.

### **Qualifications of Directors**

Tsui and Gul (2000), state that the quality of directors is more important than the quantity for effective corporate governance. Hence, in addition to investigating the number of independent non-executive directors of the listed banks, the quality of its board members was also analyzed. It was assumed that those with Masters Degrees or professional doctorates were of good 'quality'. Table 6 shows that overtime four of the banks showed an increase in the number of Masters Degree holders. It is to be noted that the Liu Chong Hing Bank Ltd. Showed a decrease of two master's degrees, this was due to the directors gaining doctorate degrees; information in this regard was not available for Liu Chong Hing Bank Ltd. And standards chartered.

With regard to doctorate degrees, there was no significant change apart from Liu Chong Hing Bank Ltd. As noted earlier. Only one bank reported a decrease in the number of directors holding a doctorate degree and this was due to resignation. Overall, all the 11 banks that provided information all of them exhibited some sort of improvement in education in good 'quality' corporate governance, also known as Director Governance (Barnes and Kwan, 2006).

### **Other Directorships Held**

It is noted that of the 12 banks, five indicated no change in the number of outside directorships held, although all showed that significant percentage of directors held outside positions (Table 8). Four banks showed an overall decrease in directorships of (between one and three directors) and this was mainly due to changes in directors and three banks indicated an increase in outside

directorships held due to changes in directors and three banks indicated an increase held by current directors. It is noted that four banks had 100% of their directors with other directorships, and another five banks had over 70% with other directorships. Only one bank had less than 50% other directorships this was in 2006 (down from 50%) due to a changes in directors. Holding of other directorships is indicative of business acumen and esteem, all indicated by the banks, as well as of good Director Governance?

## **AUDITORS**

All 12 banks were audited by the big four firms, namely Ernst and Young, Pricewaterhousecoopers (PWC), KPMG and Deloitte Touche Tohmatsu Ltd. (Table 9). It is generally assumed that the big four audit firms exhibit more stringent applications of the 'true and fair view' application in terms of corporate affairs. It was noted that the industrial and commercial bank of China (Asia) Ltd., changed auditors (from one big four to another); however, this was due to some issued related to the group and to align the group accounts for consolidation purposes.

## **Any learning or contribution the paper brings for the Banking sector in general and Hong Kong in particular**

Hong Kong's banking sector is highly open, being the second largest international banking sector in Asia after Japan in terms of the volume of external transactions. The success of the SAR's banking and financial services economy is largely a consequence of a non-discriminatory low tax regime. Business profits are taxed at a maximum rate of 16.5% whereas employees pay a maximum tax on salaries of 15%. Low tax rates are complemented by the absence of a number of types of taxation. Thus (save in very limited circumstances) there are no withholding taxes, no taxes on interest, no capital gains taxes, no sales tax or VAT and income arising outside the jurisdiction is not taxable in Hong Kong under the "territorial principle". Deductible allowances are equally generous.

A major liberalization measure went into effect in January 2011 under the closer Economic Partnership Arrangement (CEPA) between Hong Kong and china. This allows a Hong Kong bank that has maintained a representative office in china for more than one year to apply to set up a wholly foreign funded bank or a foreign bank branch. A Hong Kong banks operating institution in china can apply to conduct renminbi business, if it has been operating for more than two years

and has been profitable for one year prior to the application. Other aspects are:

- Anti money laundering
- Accounting standards
- Deposit protection scheme
- Capital adequacy rules
- Banking stability review

## CONCLUSION

This study is an examination over a three-year period of corporate governance practice of the twelve listed banks in Hong Kong. The study shows that over time and with the application of the Hong Kong on corporate governance practices (2004) the listed banks in Hong Kong demonstrated strengthening of their position in terms of banking sector governance. The banks generally do not have duality of CEO and chairman; have more than three independent non-executive directors; a mixture of qualified directors in terms of holding masters and doctorate degrees; encourage holding of outside directorships to enhance the experience and business acumen; and use big four audit firms to apply more rigid application of corporation laws and accounting practices.

While the listed banks in Hong Kong displayed banking sector governance in good measure, their directors exhibited director governance in equal measure and both showed improvement over the three-year period, i.e., from 2004 to 2006. The continuance of corporate governance practices within the banking sector then is the most likely reason why Hong Kong has remained an important international financial center with an orderly commercial environment.

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