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27 January 2012

The Hon Tsang Chun Wah John GBM JP
Financial Secretary
The Financial Secretary's Office
25/F, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

Dear *Mr Tsang*

HKIoD's Recommendations for the 2012-13 Budget

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our views for your consideration in preparing the 2012-2013 Budget.

HKIoD is Hong Kong's premier body representing professional directors working together to promote good corporate governance. We are committed to promoting director professionalism and good corporate governance, as well as contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In relation to the 2012-2013 Budget, we have consulted members and conducted focused review by our Economics & Public Affairs Committee under the chairmanship of Prof Christopher To. Hence, the response represents our consolidated views.

Should you require further information regarding our submission, we will be pleased to meet and discuss with you at your convenience.

Thank you very much for your kind attention.

Yours sincerely
THE HONG KONG INSTITUTE OF DIRECTORS

Dr Carlye Tsui

Enc

cc: Dr Kelvin Wong, Chairman, HKIoD
Prof Christopher To, Council Member, HKIoD &
Chairman, Economics and Public Affairs Committee

HKIod's recommendations for the Government Budget 2012-13

The Hong Kong Institute of Directors is convinced Hong Kong remains a place with much potential to fulfill its many ambitions and aspirations. As we near the end of the present term of Government, we once again ask this Government to resist the temptation to shun responsibilities and defer matters to the new administration. We ask the Financial Secretary and the political team to not just act to make for smooth transition but demonstrate their commitment and foresight in laying the solid ground work necessary to make Hong Kong ready to fulfill its many ambitions and aspirations.

To shore up the economy and to keep its competitive edge should remain a key focus in this year's budget.

Given the recent turn of events that shed much uncertainty in the state of the economy, we agree this year's budget should also pay attention to helping small businesses weather the storm and supporting the squeezed and the disadvantaged to cope with the hard times.

The availability of tax incentives and concessions, which has the effect of lowering the effective tax rates for businesses, is an important factor for investment decisions. Our neighboring jurisdictions are all competing with Hong Kong for investments, and they offer tax incentives and concessions in many forms and shapes to do so. This has dulled so much the Hong Kong tax system's competitive edge. We urge the Government to review the tax regime and to add or augment tax incentives to better match business needs.

Appropriate incentives and concessions have also the effect of channeling investments into areas of the economy we want to develop, and of shaping and changing behavior towards alleviating some of our livelihood, welfare and environmental issues. We ask the Financial Secretary to make good use of these devices in this budget.

Our Economy and our competitive edge

We expect the Government to take further bold steps to grasp the opportunities created by the 12thFYP and to implement the many initiatives brought to Hong Kong by Vice Premier LI Keqiang. As Hong Kong aligns its strategic direction with the goals of national planning, the Government must also crystallize the winning tactics and be prepared to adopt appropriate budget measures to take us forward.

The financial sector

➤ *Attracting issuers from all over*

We support further moves to attract issuers from the emerging markets as well as from the developed economies to raise capital and list in Hong Kong.

- *Hong Kong Stock Exchange and the Mainland exchanges*
We are open to the idea of further, closer cooperation between the Hong Kong Stock Exchange and the Mainland exchanges. Where appropriate, we will be delighted to work with appropriate parties and the community at large towards that end.
- *Promote the asset management industry*
We look forward to further measures to enhance Hong Kong's position as a major asset management centre.
- *Financial market regulations and corporate governance*
To play its proper part as a major international financial centre, Hong Kong must keep up with other major financial markets at efforts to improve banking and financial regulations, and to raise corporate governance of public companies.

Renminbi business

Mr. Financial Secretary, roll out further initiatives and measures to better develop Hong Kong as the choice offshore Renminbi business centre.

The bond market

Mr. Financial Secretary, make Hong Kong live up to its words. Make Hong Kong a real bond market centre.

We are pleased with the developments thus far in RMB denominated bonds, and expect further progress. We are open to further issuance of iBonds.

As we have previously advocated, Government bonds could also be the means to finance high price tag solutions to some of our social problems. Take traffic congestion in cross harbor tunnels as example. We have previously advocated that the Government should present firm plans to even out the traffic among the three cross harbor tunnels. We view this less an issue of insufficient capacity to meet cross harbor traffic demand, but more an issue of an uneven distribution of traffic due to wrong pricing incentives. It is conceivable that we can sell bonds to raise the war chest required to re-acquire the interests in the tunnels to better manage usage and traffic flow.

It is also conceivable that we sell bonds to finance other new infrastructure projects. For so long as these projects have the ability to generate toll revenue over an appreciably long service life, there will be a credible ability to meet the obligations on these bonds. Monies will be necessary to redeem the instruments at maturity, but that will only come in tranches, dampening the fear of having to spend too large a sum in one shot.

These bonds should have a variety of tranches, with a significant quantity with tenors 10 years or longer to create market depth.

These bonds could also be marketed as income products suitable for retirement savings. Indeed, Government bonds could have a place in the MPFs and pension plans for employees, as well as being the nest eggs for retirees who are living longer and spending more years living on their retirement savings.

From a tax perspective, there is an argument for profits tax exemption on interest income from bonds issued in Hong Kong. This could further stimulate demand for local bond offerings and thus develop the local bond market.

The service sector

Fostering the growth of domestic service industries is one major element of Mainland's 12th Five year Plan, and this presents a great opportunity for Hong Kong services. We look forward to complementing measures to help Hong Kong service firms enter the Mainland market.

The springboard for business coming into and going outside China

Hong Kong is a major center for professional services involving cross-border matters. It has much to offer to China enterprises seeking to expand business reach around the globe. Hong Kong is also an ideal place for setting up regional headquarters or holding companies of business enterprises. If Hong Kong can reinforce itself as the choice location of regional headquarters or holding companies, it will draw and retain a strong pool of talents with responsibility to manage and direct company affairs. It will also attract experienced personnel from various professional services to Hong Kong. We again ask the Government to introduce "group loss relief" and other tax incentives and exemptions to support this development.

Cross straits interactions

Hong Kong's financial market remains an attraction for Taiwan businesses to raise funds. Hong Kong can in turn tap into the high technology of Taiwan businesses. Mr. Financial Secretary, roll out incentives and support so Hong Kong businesses can benefit from improving cross straits interactions.

Towards a creative economy

A community that supports entrepreneurship will be a community that supports a creative economy. We again ask the Government to put forth strong measures to make Hong Kong an idea factory for innovators to turn creative ideas into sought-after products and services.

➤ *Hong Kong the hub of creativity and innovation*

Hong Kong can combine the research capabilities of the Mainland and Hong Kong universities and R&D centres, link up the manufacturing capacities on the Mainland or elsewhere, and draw on its capital market to provide access to investments and venture capital.

Though mass production capacities are available on the Mainland or elsewhere, prized skills and craftsmanship that once made Hong Kong proud remain found among some Hong Kong workers. They are eager for renewed opportunities to put their skills to use.

They have the ability to fabricate those specialty parts or to accomplish those intricate work steps required by innovative designs. Great things can still be Made in Hong Kong with pride. Manufacturing of a different, higher end kind can still happen here. If only Hong Kong can truly support entrepreneurship.

Stronger incubation programmes and more channels and platforms for active design knowledge exchange networking will bring designers closer to manufacturers and investors. More generous tax incentives, ones that are consistent with the common way in which R&D are done and in which IP are owned and licensed, will encourage new entrepreneurs to put efforts into developing high value-added products and services. Further supporting measures will entice existing manufacturing enterprises, many of them SMEs, to put efforts into upgrading products and services through design and innovation.

An environment that supports entrepreneurship will not only foster the growth and development of home-grown enterprises. It will also attract talents to move to the territory.

➤ *Creative clusters*

A community of people who show a sophisticated appreciation of arts and culture and who have access to wide ranging forms of performances or exhibitions are likely those who have the better seeds to creativity. The West Kowloon Cultural District shall be one key hub of arts and culture. We need, and we can spring other venues for arts, design and creative activities to form creative clusters around the territory. The former Central Police Station, former Police Married Quarters and other heritage sites are all possibilities.

➤ *Patent examination system and patent professionals*

Hong Kong should have its own original patent examination system, and a class of patent and intellectual property professionals who can help inventors and entrepreneurs, first to protect their creative inventions and other intangible assets from infringement, and also to raise monies for their further development and to turn them into products for the market.

➤ *Nurture the would-be entrepreneurs*

Rally the talents we have in society to give business advisory to would-be entrepreneurs. We often think of social enterprises offering services and products directly to customers in need. We can conceivably also have social enterprises providing advisory and consultancy services to would-be entrepreneurs wanting to start a business or to fledging social enterprises wanting to upgrade and expand. Retired but still energetic business professionals may be the ideal candidates to lead and operate such advisory consultancy services.

Support the SMEs

Help them with cash flow, help them cope with the cost of doing business

Mr. Financial Secretary, help small businesses cope with the cost of doing business. These could include profits tax concessions, additional deduction allowances on business costs that smaller businesses routinely and legitimately incur, longer time window for them to pay taxes, and simpler paperwork associated with tax returns.

Revive the Special Loan Guarantee Scheme

We find merits in reintroducing the Special Loan Guarantee Scheme.

Tax treatment of “import processing” arrangements

Mr. Financial Secretary, rectify the disparity between “contract processing” and “import processing”. Our view is:-

- for Mainland manufacturing operations conducted by Hong Kong entities that are in substance “contract processing” in nature, then, regardless of the actual legal form of the arrangement, they should continue to be permitted the 50:50 apportionment of profits;
- for arrangements that cannot for one reason or another qualify themselves for the 50:50 apportionment, they should not be dealt a double blow, as in the current practice, by denying them a claim on depreciation on the plant and machinery used in the manufacturing processes. There should be appropriate law or rule changes to exclude the application of Section 39E of the Inland Revenue Ordinance to the plant and machinery used in the production of goods under processing trade arrangements.

Nurturing the right talents for success

Corporate governance training

Rewriting Hong Kong’s company law lends a perfect opportunity to enhance corporate governance. Company directors are ultimately responsible for corporate governance. Better quality company directors should mean better corporate governance.

The Companies Bill will write into the statute a duty of care, skill and diligence for company directors. If we want more from directors, then give them tools to perform and shields to protect.

If we are to make directors more accountable and to have higher expectation on how directors are to perform, there should also be in place complementary measures and mechanisms to work in tandem. Directors need rules that will protect them when they make good faith business judgment and decisions. They need adequate indemnification, insurance or other risk coverage to shield their exposure. They should be required to have a proper level of qualification before taking office. They should be expected to continually upgrade and improve their skills and knowledge. There should also be widely-accepted and recognized reference guides to their conduct and behavior.

Mr. Financial Secretary, the Stock Exchange of Hong Kong has made a change to stipulate in the Listing Rules the HKIoD's *Guidelines for Directors*, among other guidelines published by the HKIoD and by the Companies Registry, as reference to improve listed company directors' understanding of their duties. The HKIoD *Guidelines for Directors* carry principles that are applicable to directors of all business entities, not just those listed.

Directors of all sorts operating in Hong Kong should be alert and knowledgeable about what they are asked to do and how they ought to perform their duties. That comes from proper initial training, to get them ready, and through continuing development, to keep them up.

HKIoD has long supported the promotion of corporate governance training. All company directors, when they first assume their posts, should have a firm measure of competence to perform. Over time, they should strive to remain up-to-date with best corporate governance practices.

We ask the Government to consider stipulating in the Companies Bill or otherwise to require:-

- all new appointees to the boards of listed companies to attend one or more mandatory initial training courses of specified length and content;
- by a certain date to be determined, all directors of all Hong Kong companies and all listed companies to have gone through mandatory initial training courses of specified length and content; and
- all directors of all Hong Kong companies and all listed companies to fulfill certain specified number of accredited hours in continuing professional development training over annual or other appropriate periodic cycles.

HKIoD has a continuing professional development requirement for its members, and we believe in allowing a broad range of learning activities to qualify as accredited training activities. HKIoD offers its members a variety of training courses and events with opportunities for learning. HKIoD also recognizes self-directed learning. We also grant reciprocal credits to appropriate course offerings or learning activities organized or offered by other institutions or professional bodies. We submit that the mandatory initial training and continuing professional development requirements are not onerous on company directors.

There is evidence of an ever stronger appreciation that company directors must have and must continue to improve on their skills, knowledge and qualities required to meet the corporate governance demands of today. The benefit of proper initial training and continuous professional development for directors will flow not only for big corporations but also small companies, and not only for profit-making ventures but also social enterprises and charitable organizations.

SMEs will benefit from corporate governance training

Many SMEs are not able to take full advantage of the SME Loan Guarantee Scheme and the Special Loan Guarantee Scheme. There are a number of reasons for this, but one common impediment is that many SMEs could not demonstrate proper internal control and are ill-prepared to submit sound loan proposals. A better corporate governance scorecard will make it more likely for a business to obtain credit and financing. The Government will serve the economy well to roll out measures to help owners and directors of SMEs obtain training to enhance their corporate governance practices.

The right talents for the right jobs

It is important to support the nurturing and development of our workers, since they are the human capital important to the success of Hong Kong's future. Continuing education has got more expensive, however! The restrictions and conditions for the current \$10,000, once a lifetime, maximum subsidy for continuing education deserve to be re-examined. For instance, the lifetime cap should be increased, or a rolling cap be introduced. The aim is to make the scheme more flexible and accessible. The self-education expense allowance also deserves to be raised.

Case for 15-year free education

We believe our society has the means to afford 15-year free and universal basic education, grooming our talents from before primary school until they are ready for tertiary education.

Infrastructure to match development

Air transport

A third runway will increase the volume that can be handled at take-off and landing, but air traffic is also constrained by air corridors available for flights. To facilitate air travel between Hong Kong and Mainland cities, we ask the Government to work with Mainland authorities to open up additional air corridors.

Inter-airport rail link

The third runway proposal must also be considered together with other infrastructural development initiatives. We ask the Government to work with Mainland authorities towards a firm timetable for the rail link between the Shenzhen Airport and the Hong Kong International Airport. This should include a stop in Qianhai district with connections to the larger Shenzhen area.

Pipelines and water conservation

Mr. Financial Secretary, accelerate the pace at which old outdated underground water pipes are replaced. This will save water and be good for the environment. This will also create jobs for many construction workers.

Prisons up north

It is a sad fact that Hong Kong still faces a problem with prison overcrowding. Hong Kong lacks space to build more facilities, but the Hong Kong Correctional Services does have some

highly-regarded expertise in penal management. If Hong Kong can export transit operation and management, it is not inconceivable for Hong Kong to look north for the space to build correctional facilities under its management and supervision.

Keep costs within budget, keep projects on schedule but not sacrifice quality

As projects compete for construction materials and labour, their final price tags can jump. Mr. Financial Secretary, keep project costs within budget. Keep projects on schedule for timely completion, but do not sacrifice quality and safety.

A new generation of construction workers

With more construction projects going to start, we believe a small temporary import of construction workers may be necessary to reduce acute shortage. In the longer run, however, we must devise further plans to encourage youngsters to get up-to-date construction skills training and to enter the construction industry.

Land resources and housing

Land policy

Land supply should not just be a matter of revenue generation. The decisions to put Hong Kong's land resources to various use must not only comport with strategic developmental goals but also with sustainable development of the territory on a general scale. Hong Kong can already expect the resident population to continue to grow. Integration with the Pearl River Delta and the rest of the Mainland will mean Hong Kong also has to host a growing floating population. All these trends in demographics call for a rethink of how to utilize Hong Kong land resources to keep Hong Kong a pleasant livable place.

Public rental housing

Low income families certainly deserve our help to provide them with public rental housing. We ask the Government to make good on the promise of the three year waiting time.

Extend home loan interest deduction to cover rental expense

We ask the Financial Secretary to consider the merits of extending the home loan interest deduction to cover rental expense.

A pleasant livable environment

Of cars and air quality

If too many cars are considered a cause of poor air quality, we ask the Government to consider introducing road pricing in congested zones.

Garbage ... what to do with our garbage?

If we are to institute a levy on garbage disposal that is fair, we must first have in place the infrastructure to segregate waste at the source and to make better use of the recyclables. We ask the Financial Secretary to roll out further measures to support the recycling businesses. Create incentives for residential and commercial buildings to reduce waste and keep recyclable

materials off our landfills. Stop discarded electronic products from causing more damage to our land.

We should also have plans to introduce advanced incineration and other waste disposal technologies.

Food safety

Much food we consume is imported and a threat in food safety affects many. Mr. Financial Secretary, make sure our food safety detection apparatus is on the alert to act and protect.

Livelihood – relief for the squeezed and the disadvantaged

The HKIoD believes we must rely less on welfare but more on giving people the ability and means to improve their livelihood. Yet, we agree that public resources should be used in appropriate circumstances to help the squeezed and the disadvantaged.

Over the past year, public utilities and public transport companies are putting in place substantial fare increases. Products from the Mainland and other places are costing more and there are signs this will escalate. From housing to clothing, costs are rising. A broad spectrum of the working population, even for the more educated and trained, find it hard to keep up with rising prices.

We welcome the relief measures announced in the Policy Address 2011. We must, however, be mindful that one-off reliefs could still have the undesirable effect of leaving out those most in need because they simply don't qualify.

We are not in favour of another round of cash handouts.

We expect appropriate increases to salaries tax allowances to relieve the burden of the middle class.

We have reservations about granting across the board electricity charges subsidy again. Despite increases in tariffs, we believe the electricity charges are still low relative to many users' affordability, and the tariff scales are not sufficiently progressive to encourage energy conservation.

Transport subsidy and the commute

We continue to believe that there is a better rationale to award transport subsidy on an individual basis.

We continue to believe in the merits for an integral public transport solution for those who need to make long commute to get to work. To us, that would entail strategic placement of transfer points, a better transfer fare mechanism and the wider adoption of monthly or weekly travel pass across different public transport service platforms.

- END -