

Corporate governance in Hong Kong and the rest of China

Corporate governance in Hong Kong

In our book, *Understanding Corporate Governance in China*,¹ Greg Li and I explain how, after 150 years of British rule, in 1997 Hong Kong was returned to China, under the joint Sino-British agreement, known as the Basic Law, founded on the notion of 'one country, two systems.'

The Basic Law provided Hong Kong with a *de facto* constitution, providing for a continuation for 50 years of many of the existing ways of life, including British-style common law, with an independent judiciary, its own currency, the right to tax, and a limited form of democracy, with elections through representative constituencies, overseen by a Hong Kong Legislative Council (known as LEGCO).

This situation continued until 2020, when Beijing passed the National Security Law (NSL), covering Hong Kong, without consultation and without LEGCO involvement. At the time, many thought this was no more than a response to student calls for independence for Hong Kong associated with wider civil unrest pressing for more democracy. A year's experience of the Act suggests otherwise. In fact, the NSL seems now to be providing Hong Kong with an alternative constitution, overriding the Basic Law.

Essentially, the NSL makes any act by a person or organisation deemed a threat to China's national security a criminal offence with severe penalties. The Act does not define 'national security.' Unlike legislation passed by LEGCO, which followed the British legal practice of detailed laws extended by precedent. By contrast, the NSL, which was drafted in Beijing, is broad, leaving its interpretation to state authorities. The NSL does not define 'national security' but includes any act deemed likely to affect economic security, financial security, cyber security, technological security, commercial security, or any other aspect of national security.

¹ Tricker, Bob, and Greg Li (2019), *Understanding Corporate Governance in China*, Hong Kong University Press, Hong Kong

What might constitute a challenge to national security in Hong Kong is determined by Hong Kong's Chief Executive, supported by Hong Kong Government officials, all approved by and in most cases appointed by the authorities in Beijing.

Implications of the National Security Law

The immediate result of the NSL was the closure or movement abroad of NGOs devoted to wider democracy in Hong Kong. A few citizens and corporations also relocated overseas. However, a year's experience of the NSL has suggested wider implications, including many for corporate governance.

The broad sweep of the NSL meant that it embraced not only obvious security threats, such as acts of civil disobedience, but could include all media communications, any publication by a company in a company meeting, public or private, indeed, all forms of communication and all records. The Act could be applied to company meetings including meetings of shareholders, management, the board and board committees, and interactions with customers, suppliers, and sources of finance.

The NSL is likely to prove a particular challenge to international companies operating in Hong Kong and Chinese companies with connections abroad, because many of the perceived threats to China's security are likely to involve overseas interests. For example, an American company, fulfilling United States demands for sanctions against China, could find itself in trouble with the Chinese authorities for threatening China's security.

A successful prosecution under the NSL could penalise a company and its executives. For an overseas company, this could mean that one of their executives, even though only transiting through Hong Kong, perhaps on-route from the Philippines or Vietnam to New York, could be arrested. The reverse of the situation has already been seen when the Finance Director of Huawei, the vast Chinese electronics company, with close ties to the Chinese Government, was arrested when changing planes in Canada, on an extradition warrant issued by the United States, for a crime allegedly committed by Huawei.

The Chinese authorities have responded to similar concerns expressed by other commentators (Kwok and Donkervoort, 2021)² by suggesting that China is unlikely to act prejudicially to its own economic and commercial interests.

Of course, business will continue in Hong Kong, as companies and entrepreneurs recognise the opportunities, both in Hong Kong and mainland China, taking inherent risks into account. But the inevitable effect of the NSL will be a greater degree of caution and the likelihood of self-censorship in meetings and communication.

Boards of companies involved with China need stated policies that ensure their corporate activities meet possible challenges under the NSL. Such policies might need procedures to monitor the political and legal application of the NSL, and protocols that identify possible exposure to national security issues, that assess the risk, and report to the board or a board committee for appropriate action, which could be to do nothing, adjust that activity, or drop it immediately.

Corporate governance in mainland China

In our 2019 book, Gregory Li and I describe corporate governance in mainland China as an evolutionary process, in which the Government recognised the importance of corporate governance, seeing it as the way to economic growth, rather than as a regulatory process. Recently, however, that evolution has moved on. China no longer expects the double-digit growth which propelled it, through twenty years of economic success, to become the second largest economy in the world.

Over-gearing in the property sector has exposed weaknesses in financial institutions. An ageing population challenges the growth stemming from earlier migration from village to city. China also faces a growing social disparity between a newly created affluent middle class and the remaining predominantly peasant population. Political and trade relations with the United States and Europe have exacerbated economic challenges.

Consequently, China has become more assertive in its relations with its own private sector. Freedoms preciousy granted to create markets, expand abroad, float on stock markets even in America, have come into focus and, in some cases, have been curtailed, particularly

² Kwok, Dennis W...h. and Elizabeth Donkervoort (2021), *The Risks for International Business*, *The Ash Centre for Democratic Governance*, Harvard University

where companies and their leaders were seen to be acquiring significant power. The failure of the Ant Financial Group's gigantic IPO (discussed in a previous blog), at the insistence of the Beijing authorities, provides a clear example. It seems that the regulatory authorities' oversight, including the Ministry of Finance, the Bank of China, and relevant sector agencies have all tightened their governance oversight. Corporate governance throughout China remains an evolutionary process, in which the Chinese Government plays a fundamental role.

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