



SRI MARKETS IN ASIA

HONG KONG

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1. Executive Summary

Sustainable and responsible investment (SRI) has been growing rapidly in the US and Europe since the mid-1980s. In Asia there has been little development of SRI, except in Australia and Japan, up to the present. The long-held view has been that SRI is not suited to Asian investors. However, a similar view was once held in other SRI markets such as the UK and US, but history proved otherwise. There is every reason to believe Hong Kong is ready for SRI, that more funds will emerge this year and that SRI is here to stay. While acknowledging the current economic downturn, we believe SRI presents a relatively stable, long-term alternative investment for investors.

A SIZABLE POTENTIAL MARKET

Hong Kong presents a ripe market for launching SRI funds. Overseas experience shows that SRI investors are more likely to come from the caring professions such as medical professionals, teachers, social workers and charity organisations, NGOs and religious groups. Hong Kong has a sizeable pool of workers in these fields.

MPF PRESENTS OPPORTUNITIES

With the introduction of the pension scheme, the Mandatory Provident Fund (MPF), in December last year, significant new funds will flow to fund managers in Hong Kong. Every working person earning HK4,000 (US\$ 513.6) a month or more, who is not already on a recognised scheme, is required by law to contribute 5% of their salary to the MPF. Employers contribute the same percentage. One SRI option is already available to MPF investors, and logic suggests that SRI should be a cornerstone for pension portfolios in the future due to the long term nature of the investment. Contributors are, after-all, investing for a better future 30 years down the road. US, UK and Australian pension providers are already responding actively to this challenge.

HEIGHTENED CONSCIOUSNESS TOWARDS SRI ISSUES

With increased education levels and rising affluence, there is also increased public awareness towards SRI issues. Although the Hong Kong government has taken few initiatives to encourage public debate on issues such as sustainable development, existing market research shows that Hong Kong people are increasingly vociferous in their demand for a cleaner environment, better labour relations and corporate governance. Public debate about SRI-related issues are a trigger for the development of SRI funds.

2. A Sizable Potential Market

Many Hong Kong people fit the profile of SRI investors. US and European market experience indicate that SRI investors are often caring professionals, NGO workers and charity foundations. In Hong Kong, there is a sizeable pool of potential SRI investors.

The latest government figures show there are 10,419 registered doctors, 1,636 dentists, 1,344 pharmacists, and 41,503 nurses in Hong Kong. Dr Lo Wing-lok, a legislator representing the medical profession in the Legislative Council, has commented that issues such as extending no-smoking areas and pollution are very close to their interests. SRI funds with tobacco screens will best engage their attention. A study by the University of Hong Kong, Department of Health and the Oxford University in England, found that tobacco-related deaths were now the No.1 killer in Hong Kong. In 1998, they accounted for about 18% of the territory's total deaths, or one-third of deaths among middle-aged men.

There are also over 9,542 social workers and 56,700 teachers registered in Hong Kong.

The Special Administrative Region Government, which has promised to incorporate sustainable development into their policy making process, could also take the lead by offering their 182,000 strong civil service an SRI pension option.

Religious groups in the US and Europe have been in the vanguard of SRI. It is also the way that many people first encountered the idea that investment can make money and at the same time do good. Despite differing philosophies, all religions and spiritual movements share a desire for the common good. Even though Hong Kong's religious groups are generally apolitical, they are getting more involved in discussing the social agenda. During summer 2001, local church groups protested loudly against the proposed legalisation of soccer betting. In defence of religious freedom, Catholic groups have also voiced their approval for the canonisation of Hong Kong Catholic martyrs who are regarded as sinners by the mainland government.

In Hong Kong, there are over 1 million Buddhists, about 10,000 Confucians, 236,327 Catholics, about 70,000 Muslims (around 30,000 of which are Chinese) and about 300,000 Christians. Each religious group has their own representative association in Hong Kong. In Australia, church groups contribute more than half of the local SRI



The Association for Sustainable & Responsible Investment in Asia

market.

There are 279 member organisations registered with the Hong Kong Council of Social Service, most of them social workers and outreach groups. Most are also registered with the government under the category of social workers (including 9,542 social workers mentioned above).

The most telling, however, of all these statistics is that 3,435 charities or non-profitable organisations exist in Hong Kong, according to Inland Revenue Department records, as they are qualified for tax exemptions. They employ a sizeable workforce. Many of them also manage charity foundations which have money set aside for investments, such as the Hong Kong Jockey Club, university-affiliated foundations, the Tung Wah Group of Hospitals and the charity organisation Po Leung Kuk which runs schools and orphanages. SRI strategies allow many of these funds to be invested in line with the social or environmental aspirations of the charity. An initial round of queries to these organisations found that they have very conservative investment policies. Trust funds and donations, in the area of tens of millions of Hong Kong dollars, usually gather interest in US-denominated bonds and time deposits.

One example is telling. The Hong Kong Jockey Club Charities Trust, which administers donations, donate all the Club's surplus every year to charity and community projects. Charity contributions totalled HK\$12.5 billion (US\$ 1.6 billion) last financial year. In fact, the Club has made a total of US\$147 billion in donations to charitable causes in Hong Kong as of the fiscal year ended in June 2000. The Trust invested in debt securities, equities and deposits.

The striking fact about SRI is that it is the next logical conscious step for people who already give generously to charities or take an active role in their communities, especially when they see that companies are directly harming what they care for. Past experience shows that SRI has not under performed the market, the Domini 400 Social Index has outperformed S&P 500 over a three, five and ten-year horizon. Investors can also do well by doing good.

3. MPF Presents Market Opportunities

Hong Kong's pension scheme, the Mandatory Provident Fund, was launched in December 2000. Every working person earning HK\$4,000 per month or more is required to contribute 5% of their salary to the MPF, which is then matched by their employers' contribution. They cannot withdraw this money until they reach the age of 65.

Logic suggests that SRI should be the cornerstone for pension portfolios. Pension fund providers in the US and the UK are already responding. Pension by its nature requires long-term investment. Contributors are investing for a better future 30 or 40 years down the road.

MPF gives a boost to Hong Kong's fund industry as MPF providers invest the collected sum in various funds. The MPF scheme is expected to bring about an increase of US\$2–3 billion per year into the industry and will continue to do so for the next 30 years.

The number of SRI options at present is small, but there is definitely a market void waiting to be filled. Hong Kong-based Kingsway Fund Management applies SRI principles in the management of all its public funds. By the end of this year, it will launch another fund: SRI Active, which caters to a more selective group of investors who wish to employ more stringent guidelines. AMP Henderson Global Investors also markets a SRI fund in Hong Kong. Friends Ivory & Sime, one of the largest SRI money managers in Europe, is waiting for authorisation from the Securities and Futures Commission (SFC) to market its global SRI funds in Hong Kong.

As at the end of April 2001, the net asset value of MPF constituent funds was \$19.6 billion. Amongst this, 46% was invested in balanced funds (a combination of equities and bonds), 22% in guaranteed funds, 17% in equity funds, 13% in capital preservation funds, with the rest in money market funds and bond funds.

3.1 A SNAPSHOT OF HONG KONG'S FUND MANAGEMENT INDUSTRY

The Hong Kong fund management industry is international in nature. One of the key investment approaches the territory has yet to take on, compared to other developed financial markets, is SRI. Does Hong Kong want to lag behind in this respect?

The number of funds authorised by the SFC reached a record of 2,267 as of March 31, 2001, an increase of 26% over a year ago. Hong Kong's fund management industry is char-

acterised by its international nature. According to an annual survey by the SFC, at the end of 2000, about 73% of investment funds were sourced from outside Hong Kong and 58% of the assets were managed outside Hong Kong. There were 203 fund management companies in Hong Kong managing assets totalling US\$190 billion. Hong Kong will miss the opportunities to win international SRI capital if it fails to pick up on the trend towards SRI investment.

At a Glance

1. Total assets under management (AUM) stand at HK\$1485 billion, a drop of 57% year on year. The drop was largely due to lower equity prices and a generally more difficult business environment.
2. Total assets managed in Hong Kong dropped by 18% to HK\$626 billion.
3. A larger proportion of total AUM was managed in Hong Kong, doubling to 42%.
4. About 27% of total AUM were attributable to Hong Kong investors. The number of fund management companies increased to 203 from 183 a year earlier.

3.2 RETAIL EQUITY MARKET IS GROWING RAPIDLY

While MPF underlines demand for pension funds, a rapidly expanding retail investor market can buoy the introduction of SRI in Hong Kong.

The Hong Kong Exchange and Clearing Limited conducted a survey on the Hong Kong retail equity market in May 2000. It found that the number of people who had traded in the local market at least once in the past year was 1.14 million, representing 21% of the local population, compared with only 9% in 1992. Of the 1.14 million, 24% traded once or twice a year, and 17% traded stocks more than 10 times. About 49% of local turnover was traded by local retail investors last year, compared with 32% in 1995.

A typical Hong Kong retail investor is a 37-year-old white-collar worker with a monthly income of HK 16,250 (US\$2,083). The gender difference is small, with about 52% being male, 48% female. The Australian and Japanese markets reveal that the proportion of women investors is generally higher for SRI funds than otherwise. Hong Kong's investor profile, with a relatively high participation by women, is an added advantage for SRI.



Retail Participation in Trading Investment Products (As of December 2000)

<u>Type of Investment products</u>	<u>Had traded in the past 3 years</u>	<u>12 months</u>	<u>6 months</u>
	%	%	%
Hong Kong Stocks	22.5	18.3	15.8
Hong Kong Derivatives	3.4	2.5	2.9
Overseas stocks and derivatives	2.5	1.8	2.5
Funds (excluding MPF)	9	5.8	6.2
Leveraged Forex contracts	1.1	0.7	1.1
Bonds	0.8	0.5	2.1
Any of the above	26	20.9	18.8

3.3 AN EMERGING SOPHISTICATED INVESTOR MARKET

Investors who have relations with independent financial advisors are likely to be more sophisticated. IFA clients are also more likely to be wealthy individuals or families with substantial finances. By the end of May, 662 independent financial advisers (17 of them are one-person operations) were registered with the SFC.

Chris Hutchings, director of investment adviser Ernest Maude Investment Services, says his company gets inquiries about SRI from time to time. Those interested are mostly expatriates working in the region, and Ernest Maude used SRI through overseas insurance company products. Norman Chan, head of research at Allen Perkins Financial, an IFA in Hong Kong, advised about US\$100 million of client assets in 1999. This figure is down for 2000. He estimates that once SRI funds are available in Hong Kong, his clients would devote 10% to 30% of their money to SRI.

4. Heightened Consciousness Towards SRI-Related Issues

Although the Hong Kong government has taken few initiatives to encourage public debate on issues such as sustainable development, market research shows that Hong Kong people are increasingly vocal in their demand for a cleaner environment, better labour relations and corporate governance. An active debate on SRI-related issues could instigate the development of SRI funds.

4.1 SUSTAINABLE DEVELOPMENT

A Bit of History – What the Hong Kong Government Has Done

Sustainable development – a topic closely knitted to SRI, has been discussed in the corridors of the government for almost four years. In 1999, Chief Executive Tung Chee-hwa broached the subject of sustainable development. He said in his annual Policy Address (similar to the State of the Union Address by the US President) that a Council for Sustainable Development would be set up by the end of 2001 and a HK\$100 million grant made to support initiatives on educational programmes for citizens to develop a strong awareness of sustainability. Within the Administration, by the end of 2001 all bureaus will be required to carry out "sustainability impact assessments", measuring progress of major new policy proposals to make sure they match the environmental and social aspirations of the community.

A consultation was done in the autumn of 1997 to study sustainable development in Hong Kong. However it did not really go beyond defining what the term meant.

The Final Definition of Sustainable Development

Sustainable Development in Hong Kong balances social, economic, environmental and resource needs, both for present and future generations, simultaneously achieving a vibrant economy, social progress and a high quality environment, locally, nationally and internationally, through the efforts of the community and the Government.

Without Government Promotion, Sustainability would remain an Unknown Issue

In 1998, the Hong Kong government did a telephone survey to gauge the public’s knowledge on sustainable development. The results were within expectations – the public knew next to nothing about sustainable development.

Summary of Key Findings

The survey findings reveal that public awareness and knowledge of sustainable development is low. A large majority (about 90%) of the respondents had not heard of the term sustainable development. However, while respondents might not have heard of this term, they were aware of some of the key concepts i.e. to ensure a balanced social, economic and environmental development (46 %), and to take full consideration of the impacts of today’s plans on the quality of life for future generations (38 %).

Respondents knew of sustainable development mainly through television broadcasts (75%) and newspapers (62 %).

A large majority of the respondents considered the following six aspects important in the development of a good environment:

- Reduction of diseases related to public hygiene (94.3%);
- Reduction of local environmental pollution (93.1 %);
- Reduction of global environmental pollution (88.9 %);
- Conservation of energy (85.4 %);
- Preservation of cultural heritage (68.1 %); and
- Protection of natural flora and fauna (64.9 %).

A larger percentage of the respondents considered that the development plans currently adopted by the Government were insufficient in building up a good economy, good society and good environment for future generations. The percentages are given below:

Public Perception of Development Plans Currently Adopted by the Government

	Sufficient (%)	Insufficient (%)
Good Economy	19	44.2
Good Society	31.7	32.7
Good Environment	24.8	34.1

4.2 CHANGE OF CORPORATE ATTITUDE

In 1999, the government legislated that any major development projects have to go through an environmental impact and sustainability assessment. Failing to comply with environmental legislation has derailed some corporate plans. This has forced many corporations embarking on large-scale projects to give serious attention to preserving the environment.

This change in corporate behaviour and government stance is significant. SRI can only reinforce the new emphasis on environmental and social as well as economic priorities. SRI must harness the entrepreneurial spirit of Hong Kong businesses to have the greatest effect.

- 1) Kowloon Canton Railway Corporation had intended to build a spur line to Lok Ma Chau to ease cross border congestion. However the line cut through Long Valley, a vital wetland for birds, and failed the environment impact assessment. The Environmental Protection Department rejected the blueprint last November and the Hong Kong court ruled against the railway company's interests in their appeal. The KCRC has since opted for a tunnel option for the project.
- 2) Walt Disney had to undergo an environmental impact assessment before they could start construction of Disneyland on Penny's Bay, Lantau island, a virgin area. Green groups continuously monitored their environmental efforts against the assessment benchmarks.
- 3) The government encourages private property developers to build greener buildings with natural ventilation and lighting and inclusion of sky gardens. As incentives, the Government fast track plan approval for new building designs and techniques, examine the possibility of exempting green facilities from gross floor area calculation, and give open commendation for outstanding green buildings. Sun Hung Kai Properties and New World Development, two of the territory's prominent developers, were commended in February 2001 for a residential project which provided a greener environment for residents.
- 4) In April 2001, hikers and green groups won a year-long dispute to save Tai Long Wan in Sai Kung, recognised as one of Hong Kong's most outstanding areas of natural beauty, from being blighted by a major housing development. Developers had to back down after nature conservationists mounted a determined campaign against it.

4.3 CORPORATE GOVERNANCE

Fund managers agree that corporate governance is still a problem in Hong Kong. Government protection of minority shareholders' rights is weak. However investors are beginning to assert their rights as shareholders. Shareholder activist David Webb has proposed to the government the idea of charging an additional levy to fund an independent association, Hong Kong Association of Minority Shareholders (HAMS), which can pursue lawsuits on behalf of shareholders. Before that is up and running, there have already been a few cases in which shareholders have taken it upon themselves to protect their interests.

In 2000, listed company Wheelock's proposed privatisation of department store Lane Crawford hit a snag when shareholders controlling more than 10% of the company rejected the initial offer price. Wheelock was forced to raise the offer by almost 6%. Also, Templeton Asset Management managing director Mark Mobius has been championing the cause by refusing to purchase stocks from companies that place new issues without first offering the shares to existing shareholders. The public is increasingly educated about the issue and a sweeping 'Securities and Futures Bill' was introduced to the Legislative Council in November 2000 to give the regulatory body, the Securities and Futures Commission, more teeth to protect the interests of minority shareholders.

4.4 THE PUBLIC IS AWARE OF THEIR RIGHTS AND ARE ACTIVE IN POLITICAL PARTICIPATION

The Transition Project is a group of academics who since 1984 have regularly conducted surveys analysing the nature and direction of political development in Hong Kong. Their reputable surveys are considered the most representative in Hong Kong. Aspects of political-economic development are examined through the identification and interview of politically active elites, social groups, and interest groups; in-depth social sector and random surveys and participant observation. Its latest results find a population well-versed with ideas of human rights, labour relations and environmental protection. Hong Kong people are prepared to participate in political activities to fight for their rights.



Excerpts of its April 2001 results are as follows:

There is a deep dissatisfaction with the government's performance on reducing pollution. SRI is the vehicle for Hong Kong investors to invest for a better, rather than a more polluting future. People remain worried about their environment, with the total number "worried" far outnumbering those "not worried".

Are you worried or not worried about air and water pollution?

	Not Worried	Slightly worried	fairly worried	Very Worried	Don't know
July 1999	6	18	34	35	4
Nov 1999	8	18	36	38	1
April 2000	5	14	31	48	1
Aug 2000	7	17	31	44	1
Nov 2000	7	16	25	52	1
Apr 2001	8	20	30	39	3

Concerns about pollution continue to be very high. This is the one issue that consistently shows the highest degree of concern and amongst the lowest level of satisfaction. Although Hong Kong has few polluting industries, many Hong Kong employers have set up factories across the border in southern China, and air pollution has been rampant in the past couple of years. Whenever northerly winds blow, nauseous emissions from mainland China are swept down to Hong Kong. At the end of the day, Hong Kong still suffers from its own polluting ways.

Water pollution is another prime concern. Hong Kong gets its water from China and many water sources are contaminated by chemicals and animal waste.

4.5 THE WAY FORWARD FOR THE ENVIRONMENT

According to the Environmental Protection Department, three issues are likely to determine environmentalists' attention and newspaper headlines in the coming year: Waste disposal, water pollution, and air quality. Company directors cannot afford to ignore increasingly stringent environmental legislation and active green groups anymore. Devising an SRI agenda is the way forward for companies wishing to raise capital, win shareholder support and secure customer loyalty.

Waste – Landfill space is fast disappearing and will reach full capacity in 10 to 15 years' time. Waste disposal is a big problem for Hong Kong. Apart from dumping in landfills, incinerators, albeit controversial, are also being considered by the Environmental Protection Department. Company efforts to minimise waste production are lauded by the government and such companies are more likely to win new contracts. The Integer project – two demonstration units featuring intelligent and green technologies that can be applied to building flats in Hong Kong – has a strong sponsor from the government, Chief Executive Tung Chee-hwa. The units allow tenants to monitor how much pollutants they produce each day.

Water – Improvement in water quality in Victoria Harbour is urgently needed but is being delayed by disagreements over sewage treatment systems. For a developed economy like Hong Kong, it is disgraceful that near raw sewage is still being pumped directly into the harbour. The waterfront is at present silently receiving half the 6.8 million population's sewage. By official estimates, it will be at least two years before the government decides which sewage treatment system best suits Hong Kong. It will be another few years before the system is built and put into operation. Water pollution not only gives the harbour a 'fragrant' smell, but it also causes contamination of marine life and frequent red tides.

Water pollution in Hong Kong has more to do with domestic waste than industrial effluent. By building water and waste treatment into new developments, property developers can play a crucial role in the cleaning up process.

Air – Air quality has slightly improved in year 2000. Cleaning up efforts continue. The government has earmarked HK\$2 billion to subsidise public vehicles installing particulate traps. Tax subsidy is also available for taxi drivers using ultra-low sulphur diesel. The Euro III Standard, a set of stringent emission standards for new vehicles, is being enforced in Hong Kong.

5. Appendix

The charts in Appendix 1 provide more information from the latest Transition Project surveys. While the economy still dominates public concern, environmental and social aspects of Hong Kong life are important. Hong Kong people are also prepared to be active in their support of community concerns.

How satisfied or dissatisfied are you with the performance of the government on the following issues?

	Very satisfied	Satisfied	Neutral	Dissatisfied	Very dissatisfied	DK
Reducing unemployment	2	10	16	43	30	4
Implementing education reforms	2	19	15	34	21	9
Reducing pollution in Hong Kong	2	25	12	39	16	5
Increasing supply of affordable housing	1	29	15	32	13	10
Improving medical services	3	33	13	33	12	6
Consulting with the public	1	27	18	33	9	12
Defending rights of Hong Kong people on mainland	1	20	17	29	11	23
Caring for the elderly	3	40	14	29	10	4
Ensuring judicial independence & rule of law	2	29	17	26	10	16
Implementing civil service reform	2	29	19	24	8	18
Improving municipal services	2	38	21	25	6	9
Preparing to make all Legco seats directly elected	1	28	19	22	7	23
Considering tax reforms	1	28	25	21	6	19
Protecting human rights	2	40	23	20	5	11
Improving cross-border travel & cooperation	2	47	20	16	3	11

The economy still dominates Hong Kong people's concerns.

Which problem of Hong Kong are you most concerned about now personally?

	Jan 98	Apr 98	Oct 98	Nov 99	Apr 00	Aug 00	Nov 00	Apr 01
Economic growth rate	38	32	20	10	13	16	22	12
Affordable housing	8	4	2	2	1	1	1	2
Unemployment	11	27	47	48	31	40	32	40
Salary cuts, welfare cuts			5	4	6	6	4	4
Property, stock markets			4	2	3	3	2	3
Int'l competitiveness			2	3	3	2	2	2
Other econ.			4					1
Economic Issues Total	57	63	84	69	57	68	63	64
Education	4	3	4	8	6	9	10	7
Elderly	5	5	3	2	3	2	2	4
Crime	6	5	2	4	6	4	2	3
Medical	2	1	1	1	2	-	2	2
Pollution/overpopulation	1	1	1	5	10	4	2	4
Social Issues total	18	15	11	20	27	19	18	20
Corruption	1	1	-	1	1	-	--	1
Political stability	5	4	2	2	4	5	4	2
Freedom of press	2	2	+	1	2	1	1	1
Freedom to demonstrate	2	1	+	1	1	+	1	1
Autonomy of HK	2	1	+	2	2	+		1
Fair judges/freedom to travel	3	3	+	3	1	2	1	--
Competence of Tung & civil servants	-	-	-	1	1	1	1	--
(all with + above)			2+			1+		
Political Issues total	15	12	4	11	12	10	8	6



Have you attended any meetings or activities of one of the following groups in the last six months?
 (Percentage reporting membership/attendance/doesn't add to 100)

	1/ 98	4/ 98	7/ 98	10/ 98	7/ 99	11/ 99	4/ 00	8/ 00	11/ 00	4/ 01
Trade Union	6	5	8	5	5	6	8	5	6	4
Professional association	8	6	5	5	6	6	10	6	6	5
Kaifong	7	5	5	8	6	5	5	5	5	5
Mutual Aid Committee	15	13	11	10	8	8	9	9	6	7
Clan Association	3	2	3	3	2	2	2	3	2	2
Political/pressure group	1	1	2	1	1	1	2	1	2	2
Charitable Association	17	12	15	16	13	16	18	18	16	11
Recreational & cultural group	6	4	4	5	4	7	6	7	7	5
Religious group or church	20	18	18	20	15	16	21	17	19	17
Owner's corporation				12	11	12	14	12	14	13
Environmental group				5	3	4	5	5	5	4

Public's Satisfaction and Dissatisfaction Towards the Following and SRI Agenda

	Satis- fied	Dissat- isfied	SRI Agenda
Reducing unemployment	12	73	Back new industries
Implementing education reforms	21	55	Continuous learning in workplace
Reducing pollution in Hong Kong	27	55	Reduce emissions, eco-efficiency
Increasing supply of affordable housing	30	45	Community investment funds
Improving medical services	36	45	Healthcare in the workplace
Consulting with the public	28	42	Yes
Defending rights of Hong Kong people on mainland	21	40	Government's role
Caring for the elderly	43	39	Fair redundancy & retirement policies
Ensuring judicial independence & rule of law	31	36	Ethical business practice
Implementing civil service reform	31	32	Government's role
Improving municipal services	40	31	High operational standards
Preparing to make all Legco seats directly elected	29	29	Government's role
Considering tax reforms	29	27	Support progressive policies
Protecting human rights	42	25	Yes
Improving cross-border travel & cooperation	49	19	Support progressive policies