

Hong Kong Capital Markets Update

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HKEX's consultation on *Review of the Corporate Governance Code and Related Listing Rules*

On 3 November 2017, the Hong Kong Stock Exchange (the "Exchange") launched a one-month [consultation](#) to seek views and comments from the public on a series of proposed changes to the *Corporate Governance Code* and *Corporate Governance Report* (the "Code"), as well as related amendments to the *Rules Governing the Listing of Securities* (the "Listing Rules").

The consultation aims to address certain corporate governance concerns and raise the overall standard of corporate governance among issuers and directors. Five areas are identified for review by the securities regulators:

- Independent non-executive directors (INEDs)
- Nomination policies
- Directors' attendance at meetings
- Dividend policy
- Electronic dissemination of corporate communications – implied consent.

The consultation period will end on 8 December 2017.

This publication discusses the key changes proposed by the Exchange. A summary of the current requirements and the proposed changes is set out in Appendix I.

Independent non-executive directors

Overboarding and INEDs' time commitment

INEDs play an important role in assuring investor confidence, and they are expected to exercise independent judgement and guard against conflicts of interest. However, when a director sits on too many boards (i.e. overboarding), this may raise a question about whether they are able to devote sufficient time to each board.

Under the current Code Provision (CP),¹ the board should state, in the circular to shareholders accompanying the resolution to elect INEDs, its reasons for electing them and why they are independent. However, there is no explicit requirement or limit to the number of boards that a director can sit on.

In order to address concerns around overboarding, and to promote greater transparency and accountability of the nomination process, the Exchange has proposed to amend the current CP such that when INEDs intend to hold their seventh (or more) listed company directorship, the circular should also set out reasons for determining that the nominees would be able to devote sufficient time to the board. The Exchange will provide relevant guidance setting out certain considerations in assessing whether a proposed nominee may be overboarded.

Factors affecting INEDs' independence

In order to align with international practices, the Exchange proposed some amendments to the mandatory rules ("the Rules"), CPs and Recommended Best Practices (RBPs) after a holistic review of the current Rules. The proposed changes aim to promote a more rigorous assessment of INEDs' independence.

Cooling off periods for former professional advisers

Currently, the Rules require a one-year cooling off period for a proposed INED who has been a director, partner, principal or an employee of a professional adviser. The Exchange has proposed to revise the Rules, extending the period from one year to three years. A consequential amendment will also be made to the current CP to extend the period for former partners of the issuer's audit firm to act as a member of the issuer's audit committee from one to three years.

¹ The Exchange takes a balanced approach to regulate corporate governance. Recognising that issuers vary in size and complexity of operations and each faces unique risks and challenges, the corporate governance framework consists of a combination of mandatory rules, CPs that are subject to 'comply or explain' and RBPs that are voluntary.

Cooling off period relating to material interests in business activities

Under the current Rules, the Exchange will take into account a proposed INED's *current* material interests in the issuer's principal business activities while making no mention of *past* material interests. The Exchange proposed to revise the Rules to introduce a one-year cooling off period. There was no change to the concept of material interests.

Cross-directorships or significant links with other directors

Currently, there are no restrictions on INEDs' cross-directorships or having significant links with other directors through involvement with other companies or bodies. In order to improve the transparency of INEDs' relationships with issuers, the Exchange proposed a new RBP to recommend voluntary disclosures of an INED's cross-directorships or significant links with other directors in the corporate governance report.

Family ties

Under the current Rules, the independence of a proposed INED's immediate family members² is not considered. The Exchange has proposed to introduce a Note under the independence criteria rule to encourage the inclusion of an INED's immediate family members' connection with the issuer in his independence assessment.

Board diversity

Board diversity promotes effective decision-making, enhances corporate governance and is an increasingly important factor for investors when making investment decisions. Recent statistics reveal that Hong Kong lags behind other international markets in certain aspects, in particular around gender diversity at the board level.

In order to encourage issuers to consider and explain their considerations in relation to diversity, the Exchange proposed to upgrade a current CP to a Rule, requiring issuers to have a diversity policy and to disclose the policy or a summary of the policy in the issuers' corporate governance reports. Guidance on diversity policy will be introduced in due course.

The Exchange also proposed to revise the current CP to further require the board to state its diversity considerations in the circular accompanying an INED appointment resolution, including:

- The process used for identifying the nominee
- The perspectives, skills and experience that the person can bring to the board
- How the nominee would contribute to diversity of the board.



Appointment of INEDs

Issuers are reminded to take into account the new proposals when appointing new INEDs. In particular, considerations should be given to:

- Whether they are able to devote sufficient time to the board if they are overboarding
- Whether they meet the strengthened independence criteria
- How they will contribute to the diversity of the board.

Nomination policies

Under the current Rules, the nomination committee is required to disclose a summary of work performed during the year in the issuer's annual report.

To increase transparency, the Exchange has proposed to include the nomination policy adopted by the issuer during the year as an additional mandatory disclosure.

Directors' attendance at meetings

Directors' attendance at general meetings

The current CP states that directors should attend general meetings and develop a balanced understanding of the views of shareholders. A strict interpretation of this provision would suggest that any director's absence from a general meeting would result in a deviation from the CP.

The Exchange has proposed an amendment to clarify that there is an expectation for non-executive directors (including INEDs) to attend all general meetings, but the absence of any directors at general meetings will not be considered a deviation from the relevant CP.

Chairman's annual meetings with INEDs

Under the current CP, the chairman should hold meetings – at least annually – with the non-executive directors (including INEDs) without the presence of executive directors and management.

The Exchange has proposed an amendment to require that INEDs should attend meetings with the chairman at least annually without the presence of other non-executive directors.

² The definition of 'immediate family member' in Rule 14A.12(1)(a) is also appropriate for assessing the independence of INEDs. The immediate family members of a person includes their spouse and their (or their spouse's) child or step-child, natural or adopted, under the age of 18 years.

Dividend policy

Currently, the Exchange recommends that listing applicants disclose dividend policy information in their listing documents, such as the expected dividend pay-out ratio and factors to be considered when determining discretionary future dividends. However, there are no disclosure requirements relating to the dividend policy of listed issuers.

Given that dividend policy is important for an investor in assessing an issuer's capital discipline and making an informed investment decision, the Exchange has proposed to introduce a CP requiring the issuer to disclose its dividend policy in the annual report.

Electronic dissemination of corporate communications – implied consent

Under the current regime, issuers are required to notify their shareholders of any new corporate communications via print copies, unless express or deemed consent has been obtained from their shareholders in writing. These practices may be considered outdated and not environmentally friendly, and consideration should be given to adopting an implied consent regime where consent may be obtained where the issuer's articles of association state that shareholders shall receive corporate communications via electronic means, rather than providing an automatic right to receive hard copies.

The Exchange is seeking market views on whether the Rules should be amended to allow shareholders' consent to be implied for the electronic dissemination of corporate communications by issuers. However, the Exchange will not propose to adopt such a regime until Hong Kong's company law is amended to permit implied consent.

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Appendix 1 – Summary of proposed changes to the *Corporate Governance Code* and *Corporate Governance Report*, and the Listing Rules

Current requirements		Proposed changes
Part I: Independent Non-executive Directors (INEDs)		
Overboarding and INEDs' time commitment	<ul style="list-style-type: none"> CP A.5.5 In the circular to shareholders accompanying the resolution to elect a proposed INED, the board of the issuer should state their reasons for electing him and why they believe the person to be independent. 	<ul style="list-style-type: none"> Revise CP A.5.5 In addition to the current requirements, if the proposed INED will be holding their seventh (or more) listed company directorship, the circular should also explain why the person would still be able to devote sufficient time to the board.
Factors affecting INEDs' independence	<ul style="list-style-type: none"> Rule 3.13(3) A one-year cooling off period is required for a proposed INED who is a director, partner, principal or employee of a current or former professional adviser. 	<ul style="list-style-type: none"> Revise Rule 3.13(3) Extend the cooling off period from one year to three years
	<ul style="list-style-type: none"> Rule 3.13(4) No cooling off period is required for a proposed INED with material interests in the issuer's principal business activities. 	<ul style="list-style-type: none"> Revise Rule 3.13(4) Introduce a one-year cooling off period for a proposed INED with material interests in the issuer's principal business activities.
	<ul style="list-style-type: none"> Rule 3.13 The independence of a proposed INED's immediate family members is not an independence consideration. 	<ul style="list-style-type: none"> Introduce a new note to Rule 3.13 Introduce a Note recommending the inclusion of a proposed INED's immediate family members' connection with the issuer in his independence assessment.
	<ul style="list-style-type: none"> CP C.3.2 A one-year period is required for a proposed INED who is a former partner of the issuer's audit firm to act as a member of the issuer's audit committee. 	<ul style="list-style-type: none"> Revise CP C.3.2 Extend the period from one year to three years.
	<ul style="list-style-type: none"> Currently, there is no disclosure requirement relating to an INED's cross-directorships or having significant links with other directors through involvement in other companies or bodies 	<ul style="list-style-type: none"> Introduce a new RBP A.3.3 Recommend the disclosure of an INED's cross-directorships or having significant links with other directors through involvements in other companies or bodies in the <i>Corporate Governance Report</i>.

Current requirements		Proposed changes
Part I: Independent Non-executive Directors (INEDs) (continued)		
Board diversity	<ul style="list-style-type: none"> CP A.5.6 The board of the issuer shall have a diversity policy and disclose the policy or a summary of it in its corporate governance report, which is a CP subject to 'comply or explain'. 	<ul style="list-style-type: none"> Upgrade CP A.5.6 to Rule 13.92 and make consequential amendments to Mandatory Disclosure Requirement L.(d)(ii) The current requirement in CP A.5.6 becomes a Rule requirement, and it is mandatory for the issuer to disclose such information in its corporate governance report.
	<ul style="list-style-type: none"> CP A.5.5 In the circular to shareholders accompanying the resolution to elect a proposed INED, the board of the issuer should state their reasons for electing them and why they believe the person to be independent. 	<ul style="list-style-type: none"> Revise CP A.5.5 In addition to the current requirements, the board's circular should also set out: <ul style="list-style-type: none"> - The process used for identifying the nominee - The perspectives, skills and experience the person is expected to bring to the board - How he could contribute to diversity of the board
Part II: Directors' attendance at meetings		
Directors' attendance at general meetings	<ul style="list-style-type: none"> CP A.6.7 INEDs and NEDs as equal board members should give the board and any committees which they serve the benefits of their skills, experience and varied backgrounds and qualifications, through regular attendance and active participation. They should also attend general meetings and develop a balanced understanding of shareholders' views. 	<ul style="list-style-type: none"> Revise CP A.6.7 Remove the last sentence of CP A.6.7 to provide more clarity that directors' absence from a general meeting is not considered a deviation from the CP.
Chairman's annual meetings with INEDs	<ul style="list-style-type: none"> CP A.2.7 The chairman should hold meetings at least annually with the NEDs (including INEDs), without the executive directors present. 	<ul style="list-style-type: none"> Revise CP A.2.7 The INEDs should meet at least annually with the chairman, even if the chairman is not an INED.

Current requirements		Proposed changes
Part III: Other proposals		
Nomination policy	<ul style="list-style-type: none"> <i>Mandatory Disclosure Requirement Section L.(d)(ii) of Appendix 14</i> The issuer should disclose the summary of work performed by the nomination committee during the year, as well as the nomination procedures, process and criteria adopted to select and recommend candidates for directorship. 	<ul style="list-style-type: none"> <i>Revise Mandatory Disclosure Requirement Section L.(d)(ii) of Appendix 14</i> In addition to the current requirements, the issuer should also disclose its nomination policy adopted during the year.
Dividend policy	<ul style="list-style-type: none"> Currently, there is no disclosure requirement relating to an issuer's dividend policy. 	<ul style="list-style-type: none"> <i>Introduce CP E.1.5</i> The issuer is required to disclose its dividend policy in the annual report.
Electronic dissemination of corporate communications – implied consent	<ul style="list-style-type: none"> Express or deemed consent shall be obtained from the shareholders for electronic dissemination of corporate communications by issuers. 	<ul style="list-style-type: none"> The Exchange is seeking views from the public on implied consent. No changes were proposed.

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