

Hong Kong Capital Markets Update

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HKEX's Consultation Conclusions on review of the Corporate Governance Code and related Listing Rules

On 27 July 2018, the Hong Kong Stock Exchange (the Exchange) issued Consultation Conclusions on its review of 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). This follows a consultation the Exchange launched on 3 November 2017 (the Consultation).

The Exchange received 91 responses, with the majority of respondents supporting the Exchange's proposed changes in the Consultation, and some suggesting more stringent measures. The Exchange concluded that all the proposals outlined in the Consultation should be adopted, with certain modifications or clarifications.

As a result, some amendments were made to the mandatory rules (the Rules), Code Provisions (CPs) and Recommended Best Practices (RBPs). The Rules and Code amendments will take effect on 1 January 2019.

This publication sets out the observations on the impact the new requirements may have on Hong Kong listed companies. A summary of the current requirements and the amendments is set out in the Appendix.

Independent non-executive directors (INEDs)

Overboarding and INEDs' time commitment (Revised CP)

INEDs play an important role in assuring investor confidence, and they are expected to exercise independent judgement and guard against conflicts of interest. However, the more board seats a director holds, the less time there is available for them to discharge their duties effectively and to provide adequate oversight (i.e. overboarding). This may raise a question about whether directors are able to devote sufficient time to each board.

In order to address concerns around overboarding, and to promote greater transparency and accountability of the nomination process, the Exchange has amended the current CP. The amendment states that when INEDs intend to hold their seventh (or more) listed company directorship, the circular accompanying an INED's appointment should also set out why the nominee would be able to devote sufficient time to the board. The new CP applies to the INED's election to a new board as well as any re-elections to the other boards.

Point to note:

It remains the responsibility of the nomination committee and the board as a whole to conclude whether a proposed INED is able to, or has been adequately carrying out his/her duties.

Board diversity

Diversity policy (Upgraded CP to a Rule)

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 explain their considerations in relation to diversity, the Exchange upgraded the current CP to a Rule, requiring issuers to have a diversity policy and to disclose the policy or a summary of the policy in their corporate governance reports. This would make our Rules in this respect stricter than the listing rules in most other jurisdictions, such as Australia and the UK.

Circular for diversity considerations (Revised CP)

The Exchange also revised 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 the diversity of the board.

Factors affecting INEDs' independence

The Exchange made certain amendments to the Rules, CPs and RBPs in relation to INEDs' independence, with an aim to promote a more rigorous assessment in this area.

Cooling off period relating to material interests in business activities (Revised Rule)

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 revised the Rules to introduce a one-year cooling off period from the end of a material business interest in the issuer's principal business activities. There was no change to the concept of material interests.

Cooling off periods for former professional advisers (Revised Rule)

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 revised the Rules, extending the period from one year to two 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 two years.

Cross-directorships or significant links with other directors (New RBP)

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 introduced a new RBP to require the Board to state its reason if it determines that directors are independent notwithstanding that they hold cross-directorships or have significant links with other directors through involvements in other companies or bodies.

Family ties (A new Note to the Rule)

Family connections could have a strong influence on a person's independence. The Exchange introduced a Note under the independence criteria rule to apply the same independence assessment to immediate family members¹ and encourage the inclusion of an INED's immediate family members' connection with the issuer in his/her independence assessment.



Appointment of INEDs

Issuers are reminded to take into account the new proposals when appointing new INEDs. In particular, consideration 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 policy (Revised mandatory disclosure requirement)

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 requires the issuer to include the nomination policy adopted by the issuer during the year as an additional mandatory disclosure requirement.

¹ 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 include their spouse and their (or their spouse's) child or step-child, natural or adopted, under the age of 18 years.

Directors' attendance at meetings

Directors' attendance at general meetings (Revised CP)

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.

After taking considerations of the responses, the Exchange decided to make a minor modification to the CP to clarify that generally, directors should attend all general meetings.

Chairman's annual meetings with INEDs (Revised CP)

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 amended the CP to require that INEDs should attend meetings with the chairman at least annually without the presence of other directors.

Dividend policy (New CP)

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 introduced a CP requiring the issuer to disclose its dividend policy, such as the expected dividend pay-out ratio and factors to be considered when determining discretionary future dividends in the annual report.

Guidance for Boards and Directors (New Guidance)

The Exchange also published a "Guidance for Boards and Directors" (Guidance) to help directors carry out their role more effectively. The new publication contains practical advice to boards and directors on their roles and responsibilities, board effectiveness, board committees, board diversity – including gender diversity – and corporate governance for weighted voting rights issuers. There is also a section on the company secretary's role and function, in particular when the role is outsourced to an external service provider. In addition, the Guidance encourages listing applicants to appoint INEDs at least two months prior to listing.

Electronic dissemination of corporate communications – implied consent

The Exchange would not propose to adopt an implied consent regime until Hong Kong's company law is amended to permit implied consent.



Questions to ask

- Have you conducted a robust independence assessment with consideration of factors such as family ties, cross-relationship and material interest, etc. during the appointment or re-election of an INED?
- Have you identified any gaps or challenges in meeting all the disclosure requirements under the revised Corporate Governance Code?
- If you are a new listing applicant or a listed company that plans to issue dividends to shareholders in your first year, are there any challenges or concerns that hinder you from providing a disclosure to the public?

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Appendix – Summary of the amendments to the *Corporate Governance Code* and *Corporate Governance Report*, and the Listing Rules

		Current requirements	New requirements
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 board believes the individual 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. Rule 3.13(4) No cooling off period is required for a proposed INED with material interests in the issuer's principal business activities. Rule 3.13 The independence of a proposed INED's immediate family members is not an independence consideration. 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. 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"> Revise Rule 3.13(3) Extend the cooling off period from one year to two years. 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. 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/her independence assessment. Revise CP C.3.2 Extend the period from one year to two years. 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'. 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"> <i>Upgrade CP A.5.6 to Rule 13.92 and make consequential amendments to Mandatory Disclosure Requirement L.(d)(ii)</i> The current requirement in CP A.5.6 becomes a Rule, and it is mandatory for the issuer to disclose such information in its corporate governance report. <i>Revise CP A.5.5</i> 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 individual can bring to the board - How the individual contributes to the 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 benefit 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"> <i>Revise CP A.6.7</i> Revise the last sentence of CP A.6.7 to provide more clarity that generally directors should attend general meetings to gain and develop a balanced understanding of the views of shareholders. 	
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"> <i>Revise CP A.2.7</i> The INEDs should meet at least annually with the chairman, even if the chairman is not independent, without the presence of other directors. 	

		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 should have a dividend policy and disclose it 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 would not propose to adopt an implied consent regime unless and until Hong Kong's company law is amended to permit implied consent. 	