

Corporate Communications Department  
Hong Kong Exchanges and Clearing Limited  
12<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street  
Central  
Hong Kong

31 March 2011

Dear Sir/Madam,

**Re: Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules**

By way of background, Hermes is one of the largest asset managers in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including National Pension Reserve Fund, VicSuper, Pensioenfonds PNO Media, Public Sector Pension Investment Board and Lothian (only those clients which have expressly given their support to this response are listed here).

Hermes takes a close interest in matters of company law and regulation because they set the context for the exercise of our clients' rights as part owners of the companies in which they invest. We seek to safeguard our clients' current rights and also to enhance the transparency and accountability of companies and their directors to their long-term owners.

This consultation covers a wide range of issues. Before responding to some of the detailed questions, we would highlight that, as the representative of long-term investors, Hermes strongly supports the principle of pre-emption. We typically do not support general mandate resolutions to issue additional shares up to 20% of the company's issued capital without pre-emptive rights, not least given that under Hong Kong listing rules such issues may be at a discount of up to 20%. Unless companies have specific and transparent plans, we expect companies to seek a lower issue authority and provide transparent disclosure regarding the company's record of issuing shares without pre-emptive rights. We believe that it is necessary to protect pre-emption rights as a proprietary right through which the current shareholders of a company can retain their ownership without finding their interest diluted by the introduction of other investors and finance. Therefore, we invite HKEX to consider lowering the issue authority cap in the regulation to protect shareholder interests when issuers raise capital. We would also strongly urge



HKEX to minimise the scope for issuing shares at a discount to the prevailing market price. Without such changes, Hong Kong will remain a market in which international investors will have only limited trust.

## Directors

### Time Commitment:

**Q11: Do you consider that there should be a limit on the number of INED positions an individual may hold? Please give reasons for your views.**

No. We support greater disclosure of time commitments by directors, particularly Independent NEDs. However, we think it is difficult to identify any concrete cap of Independent NED seats held by a person. The situation depending on individuals' status can vary greatly. It also depends on the complexity of the businesses which will require different time commitments, and these requirements will also vary over time depending on the issues faced by the company. Therefore, we do not support to set up a limit on the number of Independent NED positions an individual may hold.

### Question 21-29: Remuneration Committee

**Q 22: Do you agree with our proposal that the remuneration committee must be chaired by an INED? Please give reasons for your views:**

Yes. We believe that the independence of the remuneration committee is important to ensure that the committee can deliver objective oversight. We support the proposal that such committees should be chaired by Independent NEDs. The chair of the remuneration committee should lead the committee to set appropriate pay programmes linked to performance that are in the company's best interests and aligned with its business mission and strategy. Considering the chair of the committee has a powerful leadership role, we agree that having an executive director in this position is wholly inappropriate, and also we cannot support non-independent NEDs in such roles. Investors hope an independent remuneration committee will link pay packages to individual and overall management performance.

### Question 30-38 Nomination Committee

**Question 31: Do you agree that the proposed CP (currently RBP A.4.4) should state that the nomination committee's chairman should be an INED? Please give reasons for your views.**

Yes, we support the proposal that the nomination committee's chair should be an Independent NED. Nomination committee plays an important role to assess the independence of NEDs, and to recommend and review the structure, size and composition of the board. It is a code provision or recommendation in most major world markets, for listed companies to set up nomination committees, with the majority of the committee as well as the chair being independent directors.

## **Question 39-45 Corporate Governance Committee**

### **Q40: Do you consider that the committees should submit to the board a written report on its work annually?**

We welcome the suggestion that committees produce a written report to the board. We would also welcome such reports in the annual report regarding the duties performed by the committees to increase their accountability and for the investors to test whether their duties have been appropriately performed.

### **Q53 Board Evaluation**

Yes. We welcome the new proposal to recommend board evaluation. We believe board evaluation will encourage boards to seek continually to enhance their performance and governance. We would also welcome a provision regarding individual director evaluation and a requirement that the chair should confirm to shareholders when proposing the re-election of a director that, following formal performance evaluation, the individual's performance continues to be effective and that they demonstrate commitment to the role.

### **Q59 Removing five percent threshold for voting on a resolution in which a director has an interest**

No. We agree that 5% threshold does not effectively promote good corporate governance. However, HKEX did not indicate other specific rules to replace the existing ones in line with investors' interests. We agree that a director may have material interest in a transaction with a company even if he is interested in less than 5% of that company's issued shares or voting rights. Furthermore, we strongly suggest the HKEX provide more specific definition of 'material interest' and the range of relationships with counterparties to a transaction. Although 5% threshold may not be the best test, we are concerned that simply removing this rule without a more specific and appropriate rule in place will loosen the protection of independent shareholders. We suggest HKEX provide a replacement rule to resolve our concerns.

### **Q77 Disclosing long term basis on which an issuer generates or preserves business value**

Yes. We support the introduction of a CP stating directors should include in the issuer's annual report an explanation of the basis on which the company generates or preserves value over the long term including its business model and corporate strategy. We believe that such clarity and transparency will help investors understand the businesses in which they invest, require clarity of thought by the board, and provide a basis for dialogue between shareholders and the company.

## **Shareholders' general meetings**

**Q80 issuers should avoid 'bundling' resolutions and where they are 'bundled' explain the reasons and material implications in the notice of meeting.**

Yes, we welcome this proposal. We agree that bundling resolutions discourages the effective communication between the issuers and shareholders and that significant controversial resolution may be hidden in the same bundle with uncontroversial proposals.

**Q 81 Allow a chairman at a general meeting to exempt procedural and administrative matters described in paragraph 274 from voting by pool**

No. We do not support this proposal due to our concerns about the definition of Procedural and Administrative matters. In 274(a), procedural and administrative matters include the matters do not appear on the agenda of the notice of general meeting or any supplementary circular to shareholders. We are concerned that other matters not listed in the agenda might lead to potential abuse of this proposal.

Despite this, we are happy with the examples provided in 275. HKEX proposes to provide guidance on procedural and administrative matters in Frequently Asked Questions to be published on implementation of its new standards. However, we suggest HKEX provide appropriate definition and explanation of Procedural and administrative matters in order to cover various scenarios and prevent potential abuse. Guidance based on FAQ may not have a strong binding effect.

In addition, in Rule 14A 18(1), 'connected persons with a material interest in a connected transaction are prohibited from voting on a resolution to approve the transaction.' As we suggested in response to Q59, HKEX should provide more specific definition of 'material interests' to promote effective compliance with these rules.

**Q85-87 Shareholders' approval to appoint and remove an auditor**

Yes. We support this proposal that the auditor should be allowed to make a written and/or verbal representation at a general meeting to remove him. It is also important that the circular to shareholders contains written representations from the auditor. Shareholders are entitled to be aware of any dispute between the issuer and the auditor in order for them to be able to make informed decisions.

**Q 88-91 Directors' attendance at meetings**

Yes. We support the expectation that NEDs including Independent NEDs should attend meetings and make positive contributions to the development of the issuer's strategy and policy. We also strongly support the introduction of a new mandatory disclosure provision requiring issuers to disclose details of

attendance at meetings by each director. We believe NEDs and Independent NEDs should commit and contribute a reasonable amount of time to board and business strategy making and if they are not willing or able to do so they should leave the board. Detailed disclosure of the attendance by each director including NEDs and Independent NEDs will help investors monitor and decide whether NEDs are able to contribute enough time to the board.

We sincerely hope that you find our comments helpful and will take them as constructive input to your approach. If you would like to further discuss any specific issues or exchange views, please do not hesitate to contact

Yours sincerely,