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Attn. Ms. Katherine Ng  
Senior Vice President  
Head of Policy, Listing Department  
12th Floor, One International Financial Centre  
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Date  
14 December 2017  
Attachment(s)  
One  
  
Subject  
Consultation Paper on Review of  
the Corporate Governance Code  
Handled by  
Mr. Gerard W.R. Fehrenbach

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**SENT by E-MAIL**

**HKEX Consultation Paper on Review of the Corporate Governance Code and Related Listing Rules.**

Dear Ms. Ng,

We welcome the opportunity to respond to the HKEx consultation on the review of the Hong Kong Corporate Governance Code<sup>1</sup> about the extension of the deadline to 15 December 2017.

PGGM Investments (hereinafter: "PGGM") is a Dutch asset manager acting on behalf of - amongst others - *Pensioenfonds Zorg en Welzijn*, the Dutch pension fund for the healthcare and welfare sector and one of the largest pension funds in Europe. PGGM currently has approximately € 206 billion assets under management. A considerable amount thereof is invested in Hong Kong and HKEX listed companies. Please be informed that we are a long term shareholder in these companies. PGGM is a member of the Asian Corporate Governance Association (ACGA) based in Hong Kong.

Please find attached hereto our comments to the questions in the consultation paper. Please note, however, that we provided an answer to all of the questionnaire's questions. As you will see from our response, it was rather difficult to fully agree with some of the proposals. Quite a few of the proposals we can support in general, but we would like to see further and stricter improvements made in the proposals or even disagree with the proposed approach to deal with the issue addressed in the question(s).

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<sup>1</sup> <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Consultation-Paper/cp2017111.pdf>.

Finally, please allow us to highlight a number of issues not included in the current consultation and we recommend HKEx consider in the near future to bring Hong Kong's corporate governance standards more in line with international corporate governance best practices:

1. Separation of roles chairman and CEO: the roles chairman and CEO are substantially different and in our view should best be filled by different people in order for a chairman to supervise a CEO. Currently, the explanations provided by companies in their CG reports as to why the roles are not split are generally limited and/or superficial and of not much use to institutional investors like ourselves. We recommend that HKEx review the options for addressing this matter.
2. Minimum number of INED and their skills: In our view, a one tier board should be comprised of at least 50% independent directors (INED's). This principle is also laid down in our global voting guidelines. Unfortunately, this principle is not yet part of the HKEX Listing Rules. We would like to stress, that apart from this quantitative target we would encourage you to set qualitative targets, such as skill sets, for INED's in order that these individuals can function as truly independent and add value in the checks and balances of the company. For example through periodic enhanced education requirements.
3. Selection, nomination and election of INEDs: We believe HKEX should undertake a review of the process in which independent directors are selected, nominated and elected, in particular within listed companies with a controlling shareholder. INED's should play a vital role in the protection of minority shareholders interest, but minority investors like ourselves have little to no opportunity to voice our discontent with the nomination process or the outcome thereof. We do believe that addressing the importance already starts before listing (pre-IPO) and companies should have a proper process in place to appoint INED's prior to listing. We refer to ACGA's submission to the SFC in July 2012 on sponsor due diligence.
4. Lead independent director: as active long term shareholders, we are engaging with companies in our portfolio as part of our stewardship efforts. In addition to management, we increasingly seeking meetings with directors, in particular independent directors (INEDs), We still encounter difficulties in this respect, even though some Asian markets have adopted practices to facilitate communication between independent directors and the chairman, and between the board and minority shareholders. The senior (also referred to as: lead) independent director (SID) concept is an efficient way to handle such demands and will likely grow in importance around Asia in future.. We therefore recommend that the CG Code be amended to encourage the appointment of a SID.

Please do not hesitate contacting me should you have any queries.

Yours sincerely,

Gerard W.R. Fehrenbach  
Attorney at Law  
Senior Advisor Responsible Investment  
PGGM Investments

Attachment: PGGM response to the HKEX Consultation Paper on Review of the Corporate Governance Code and Related Listing Rules.Questionnaire



## Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017111.pdf>.

Where there is insufficient space provided for your comments, please attach additional pages.

### PART I: INDEPENDENT NON-EXECUTIVE DIRECTORS

#### Overboarding and INED's time commitment

1. Do you agree with our proposed amendment to Code Provision (“**CP**”) A.5.5 (on a “comply or explain” basis) so that in addition to the CP’s current requirements, the board should also explain, if the proposed independent non-executive director (“**INED**”) will be holding his seventh (or more) listed company directorship, why he would still be able to devote sufficient time to the board?

Yes

No

Please give reasons for your views.

Please also refer to our letter where we highlight a number of issues not included in the current consultation and we recommend HKEX consider in the near future to bring Hong Kong’s corporate governance standards more in line with international corporate governance best practices, such as – but not limited to - (i) Separation of roles chairman and CEO; (ii) Minimum number of INED and their skills; (iii) Selection, nomination and election of INEDs: and (iv) Senior (Lead) independent director (SID).

Please note that we concur with the reasoning provided by the Asian Corporate Governance Association (ACGA), of which we are a member: We agree, in principle, with enhanced disclosure of the reasons for selecting a person as an independent director and why he or she will be independent. However, given the prevalence of concentrated family or state ownership among Hong Kong-listed issuers, we have concerns about the value of standardised statements on director independence. While the Listing Rules provides a definition of “independent director”—and this consultation seeks to strengthen it in certain areas— issuers need to be aware that the evolving expectations of global investors on independence set a higher bar than the HKEx Listing Rules. Merely stating that an INED nominee meets the criteria in the Rules may not be convincing to investors. Indeed, the critical wording above is ‘why the board believes the person to be independent’. That is, independent in practice, not just on paper.

However, we disagree with the threshold of seven (7) directorships as a definition of over-boarding for independent directors. We believe that seven is much too high a number and that four to five is more sensible. Indeed, we argued the same in our submission to HKEx on the amendment of the CG Code in 2011. But even this depends on whether an INED holds a full-time or demanding position in another company. If INEDS are non-executive chairmen of other boards, we believe they should hold no more than two to three directorships in total, since the role of chairman is a demanding one. If INEDS are executive chairmen or CEOs of other companies, they should hold no more than two directorships in total (for the sake of clarity, this includes the directorship they hold as an executive chairman or CEO).

Another way to assess overboarding—and one used by some ACGA investor members—is to accept four or five directorships as the maximum and count the role of chairman or CEOs as being the equivalent of two directorships.

## Board diversity

2. Do you agree with our proposals to upgrade CP A.5.6 (on a “comply or explain” basis) to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their corporate governance reports?

Yes

No

Please give reasons for your views.

Ditto: We agree that it makes sense to upgrade the board diversity policy from a Code Provision to a Listing Rule and to mandate disclosure of it. However, we think the language here could be more precise. We believe that any credible diversity policy should comprise the following features:

- Content that is sufficiently detailed and company specific to allow a reasonable investor to gain value from reading it. The risk of allowing a “summary” version of the policy in company CG reports is that firms will repeat the language in Principle A.3 and simply say that their board has a “balance of skills, experience and diversity of perspectives appropriate to the requirements” of their business. Or they may also copy CP A.5.6 and say their policy on the selection of directors ‘considers a number of factors, including gender, age, cultural and educational background, in addition to professional experience’.
- A focus not just on board diversity, but diversity within the workforce and management team generally. It is well-established that an impediment to gender balance in the board is the lack of “board ready” women executives.
- A description of the company’s plans for providing board-preparation training to middle and senior managers, so as to provide as wide a basis as possible for future director selection—not just to increase the number of women on the board, but men from a diversity of backgrounds and countries.
- Targets and timeframes for achieving diversity objectives: there would be little value in having a diversity policy without targets for achieving such a policy. Inertia within boards is a powerful impediment to progress.

On a related matter, it is well recognised that gender diversity is lacking in Hong Kong-listed company boards. Indeed, the HKEx consultation paper makes this clear—only 12.2% of all directorships are held by women and more than one third of issuers (35%) had no women on their boards. At the current rate of change—a two-percentage point increase every 4.5 years—it will take another 18 years before women hold 20% of all director positions. While the pace of change may well speed up in the next 5-10 years, the current figures fairly reflect the glacial approach in Hong Kong to gender diversity. Perhaps it is time for HKEx to consider a more robust policy and set quantitative, not just qualitative, targets?

3. Do you agree with our proposal to amend CP A.5.5 that it requires (on a “comply or explain” basis) the board to state in the circular to shareholders accompanying the resolution to elect the director:
- (i) the process used for identifying the nominee;
  - (ii) the perspectives, skills and experience that the person is expected to bring to the board; and
  - (iii) how the nominee would contribute to the diversity of the board.

Yes

No

Please give reasons for your views.

Ditto: We agree with the spirit of this proposal, namely enhanced disclosure on director diversity and reasons for the selection of certain individuals. We also support the emphasis on individual skills and experience—something generally lacking in reporting on board composition in Hong Kong and Asia.

We disagree, however, with leaving this as a Code Provision only, subject to “comply or explain”. Given the importance of these issues, we believe that such disclosure should be mandatory. This would also be more in keeping with the proposed upgrade of CP A.5.6 to a Rule, as suggested in Question 2.

4. Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) to reflect the upgrade of CP A.5.6 (on a “comply or explain” basis) to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their Corporate Governance Reports?

Yes

No

Please give reasons for your views.

Ditto: This makes sense in line with the upgrade of CP A.5.6 to a Listing Rule.
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## Factors affecting INED's independence

### A. Cooling off periods for former professional advisers

5. Do you agree with our proposal to revise Rule 3.13 (3) so that there is a three-year cooling off period for professional advisers before they can be considered independent, instead of the current one year?

Yes

No

Please give reasons for your views.

Ditto: We agree with the direction of this proposed rule change—short cooling-off periods clearly undermine the effectiveness of independent directors, current rules in Hong Kong are particularly weak on this point, and longer cooling-off periods should be better than short ones.

However, we disagree with the implication of the question—that a three-year cooling off period would ensure that directors, partners and employees of professional advisory firms are genuinely independent. Given Hong Kong's predominant family business culture, and the tight-knit nature of the business community, we remain sceptical that cooling-off periods are the right approach to defining independence. We are not against retired staff of professional advisers joining boards, but would prefer they do so as non-executive directors, rather than independent non-executive directors. The close relationship and loyalty between an adviser/advisory firm and a family/controlling shareholder is unlikely to diminish after three years.

We would prefer a Rule that states that former professional advisers are unlikely to be considered independent in any circumstance. Paradoxically, this might benefit issuers by allowing them to appoint former professional advisers to their boards more quickly as non-executive directors. And it would encourage them to look further afield in Hong Kong or outside for stronger independent director candidates. If this sets too high a bar, then a cooling-off period of five years would be preferable.

6. Do you agree with our proposal to revise CP C.3.2 (on a “comply or explain” basis) so that there is a three-year cooling off period for a former partner of the issuer's existing audit firm before he can be a member of the issuer's audit committee?

Yes

No

Please give reasons for your views.

Ditto: We agree with the spirit of this proposal, which is in line with the revision above on Rule 3.13 (3) and should strengthen the independence, both real and perceived, of the audit committee.

We disagree, however, in leaving this as a Code Provision subject to “comply or explain”, since this creates a potential inconsistency: if former partners/employees of professional advisory firms cannot serve as INEDs for three years, then they could also not be appointed to audit committees as INEDs during this time. It would be more consistent to reflect this in the Rules. Strengthening this CP would also address the potential problem of issuers appointing former partners of their existing audit firms to their boards as non-executive directors (NED), then inviting them to join their audit committees. Rule 3.21 states that audit committees must comprise at least three members, the majority of whom must be independent, and that the committee chairman must also be independent. This leaves room for at least one non-executive director (NED) to join the committee. However, it is likely that many investors would question the legitimacy of having any members of an audit committee linked to an issuer’s existing audit firm, since even former partners not involved in the audit previously would still have benefitted indirectly from the commercial relationship with the issuer.

## **B. Cooling off period in respect of material interests in business activities**

7. Do you agree with our proposal to revise Rule 3.13(4) to introduce a one-year cooling off period for a proposed INED who has had material interests in the issuer's principal business activities in the past year?

Yes

No

Please give reasons for your views.

Ditto: We disagree with this proposal, as we believe that a one-year cooling off period is too short. If HKEx believes three years is the appropriate minimum for professional advisers, then it would make sense to apply the same standard to people who have had a material business relationship.

Indeed, for the sake of consistency, we recommend that HKEx apply the same cooling-off period of three years across the independent-director criteria in Rule 3.13. This would mean, at the very least, increasing the current two-year cooling off periods to three years for the following individuals:

Those who are or were “connected with a director, the chief executive or a substantial shareholder of the issuer”;

Those who are or were “an executive or director (other than an INED) of the issuer (or its holding or subsidiary companies, or core connected persons)”.

However, even these changes would not resolve a key weakness in the INED definition: the fact that former executives of a company or its holding/subsidiary companies are still eligible to become independent directors. There have been cases in Hong Kong where executive directors stay on a board after retirement as NEDs, then transition to INEDs after two years. This rule is a relic of a period—the early 2000s—when the supply of independent directors was considerably smaller than today. We recommend it be removed from the INED criteria.

## **C. Cross-directorships or Significant Links with other Directors**

8. Do you agree with our proposal to introduce a new Recommended Best Practice A.3.3 (i.e. voluntary) to recommend disclosure of INEDs' cross-directorships in the Corporate Governance Report?

Yes

No

Please give reasons for your views.

Ditto: We agree that disclosure of cross-directorships is important and would provide greater transparency regarding the links between companies and directors.

However, we disagree with making this a Recommended Best Practice (RBP). At the very least it should be a Code Provision, if not a Rule. One argument in favour of a rule is that this

would locate all key requirements for INEDs in one place, rather than splitting them between the Listing Rules and CG Code. A second is that crossdirectorships highlight potential areas for related-party transactions, a key CG challenge in Hong Kong and information critical for investors.

**D. Family ties**

9. Do you agree with our proposal to introduce a Note under Rule 3.13 to encourage inclusion of an INED's immediate family members in the assessment of the director's independence?

Yes

No

Please give reasons for your views.

At this moment, we do not have any strong view on this in favor nor against. Please refer to our general comments related to the INEDs.

10. Do you agree with our proposal to adopt the same definition for "immediate family member" as Rule 14A.12(1)(a) which defines an "immediate family member" as "his spouse, his (or his spouse's) child or step-child, natural or adopted, under the age of 18 years"?

Yes

No

Please give reasons for your views.

At this moment, we do not have any strong view on this in favor nor against. Please refer to our general comments related to the INEDs.

**PART II: NOMINATION POLICY**

11. Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 to require an issuer to disclose its nomination policy adopted during the year?

Yes

No

Please give reasons for your views.

Ditto: While this proposal overlaps to some extent with the proposal above for disclosure on board diversity, requiring issues to articulate their director nomination policy would be beneficial. Many Nomination Committees are chaired by the chairman of the board or CEO (ie, insiders) and meet only once per year. This proposal may go some way towards nudging

companies to think harder about nomination and develop a pipeline of candidates into the future.

In order to avoid boilerplate, we recommend that guidance be provided to issuers on what a meaningful director nomination policy looks like, including the use of a “skills matrix” to analyse the extent of any gap between a board’s composition/skills and its current and future needs. A focus also on how the board evaluation process can lead to improved director nomination is also helpful.

### **PART III: DIRECTORS' ATTENDANCE AT MEETINGS**

#### **Directors' attendance at general meetings**

12. Do you agree with our proposal to amend CP A.6.7 (on a “comply or explain” basis) by removing the last sentence of the current wording (i.e. they should also attend general meetings and develop a balanced understanding of the views of shareholders.)?

Yes

No

Please give reasons for your views.

Ditto: Instead of removing this sentence, we recommend that it be amended as follows: “They should also attend annual general meetings and develop a balanced understanding of the views of shareholders.”

Making director non-attendance at AGMs acceptable would be a regressive step. It is understandable that directors may not be able to attend all general meetings, but they should be expected to participate in the annual meeting as a minimum. Any non-attendance should also be explained.

#### **Chairman's annual meetings with INEDs**

13. Do you agree with our proposal to revise CP A.2.7 (on a “comply or explain” basis) to state that INEDs should meet at least annually with the chairman?

Yes

No

Please give reasons for your views.

Ditto: Even if the chairman is an executive or insider, it would be beneficial for the INEDs to meet with him or her separately during the year and express their views on issues not fully discussed in board meetings, suggestions they may have for governance improvements, and any particular concerns they have about the company's operations but do not want to express in front of other executive directors or NEDs.

#### **PART IV: DIVIDEND POLICY**

14. Do you agree with our proposal to introduce CP E.1.5 requiring (on a “comply or explain” basis) the issuer to disclose its dividend policy in the annual report?

Yes

No

Please give reasons for your views.

Ditto: We agree that disclosure of dividend policies is beneficial and important. However, this should be broadened to include share-buyback and capital-allocation policies more generally.

We disagree with making this a Code Provision and believe it should be a Rule. As the HKEx paper notes, both the US and UK requires issuers to disclose a dividend policy. Since Hong Kong is also an international financial centre, it should benchmark itself in this regard against competing jurisdictions, not Singapore, which requires disclosure on a “comply or explain” basis only, or Australia, which makes it voluntary. HKEx also notes that China makes such disclosure mandatory too—another reason for Hong Kong to follow suit, as it also competes with Shanghai and Shenzhen.

#### **PART V: ELECTRONIC DISSEMINATION OF CORPORATE COMMUNICATIONS – IMPLIED CONSENT**

15. Do you think that the Rules should be amended to allow shareholders’ consent to be implied for electronic dissemination of corporate communications by issuers?

Yes

No

Please give reasons for your views.

We do see the advantage of electronic dissemination of corporate communications, as long as proper communications to all investors in a timely matter is guaranteed. However, we are very reluctant for any kind of "implied consent by shareholders", in particular minority shareholders/institutional investors like ourselves. We are of the opinion that it is best practice that all relevant matter are punt forward to the shareholders meeting (AGM) at least once, and ideally periodically for more pressing matters, we trully belief that companies that provide adequate explanation to the proposals that they put to a vote in the AGM will receive sufficient support from its shareholders.

- End -