

# RESPONSE TO THE CONSULTATION PAPER ON *REVIEW OF THE CORPORATE GOVERNANCE CODE AND RELATED LISTING RULES*

by

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## INTRODUCTION

Codes of corporate governance have come a long way since the publication of the Cadbury Report about a quarter of a century ago. It must be remembered that the committee chaired by Sir Adrian Cadbury was tasked specifically to deal with the financial aspects of corporate governance and that we have – in the intervening period since then – expanded considerably on the scope of such codes. On the other hand, the United States of America adopts a ‘black letter law’ approach with a legislative framework setting out the requirements and resulting penalties for non-compliance. It is trite that there is no ‘One Size Fits All’ as regards ‘soft’ or ‘hard’ law since market development and maturity may differ across jurisdictions compounded by cultural and/or socio-economic considerations. Accordingly what may work well in one country may not necessarily produce similar results in another which should serve as a timely warning of the numerous pitfalls to simply adopting seemingly expedient regulatory transplants.

That said, what is clear is that there must be adherence to some basic common sensical practices which transcends national boundaries especially since there is a common denominator in the corporate governance debate namely that companies always involve the use of ‘other people’s money’ for which there is a legitimate right to expect that this will be applied responsibly by those empowered to do so.<sup>1</sup> As the tentacles of the modern corporation reach further outwards so too must there be a commensurate level of corporate behavior that meets the expectations of the various stakeholders which continue to evolve.

The practice of corporate governance – together with its associated Codes as well as legislation – have evolved over the past 25 years during which time numerous corporate excesses have been

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<sup>1</sup> See for example Commonsense Corporate Governance Principles available at <http://www.governanceprinciples.org> (accessed 11 December 2017).

witnessed, leading to the Asian financial crisis in 1997 as well as the global financial crisis in 2008. The recent scandals in South Africa surrounding three different entities with significant international repute, namely, Bell Pottinger; McKinsey and KPMG South Africa, have highlighted the importance of good corporate governance and of the potentially devastating repercussions that follow the failure to recognize evolving community expectations of good corporate citizenship as well as to meet exacting standards. Although a number of fora has been set up to raise and discuss some of the issues, as well as to propose changes, it must be expressly acknowledged that despite all best intentions we must recognize the fragilities of humans which have invariably been the dominant or root cause of the crises that we have experienced to date.

## **PART I: INDEPENDENT NON-EXECUTIVE DIRECTORS**

Two principal abbreviations are adopted for this section namely INED(s) and INEDship(s) to refer to independent non-executive director(s) and independent non-executive directorship(s) respectively.

### *1. Overboarding and INED's time commitment*

I agree with the principal objective of this proposal namely 'to enhance transparency on the considerations given by the nomination committee or the board in respect of the director's time commitments when the person will be holding his seventh (or more) listed company directorship.'

However, I ***question*** why the threshold is set at such a low level as the HKEX does not provide any rationale for this number. It is trite that there will always be a gravitation towards a number that is provided and over time this will be gradually be accepted and adopted as 'the norm' evidence of which can be seen from the requirement for the *minimum* number of INEDs that a listed company should have.

A review of the List of Directors on the HKEX website<sup>2</sup> shows that only 29 individuals held more than six INEDships with the 'Top Three' together accounting for no less than 46 INEDships between them.<sup>3</sup> Thus the proposed amendment to Code Provision ("CP") A.5.5 will only affect an almost insignificant number of individuals. I expect this number to rapidly decline as no less than 16 individuals presently have seven INEDships and it is not unreasonable to expect that some of them will either resign or retire from at least one listed company so as to bring him or herself 'below the radar'.

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<sup>2</sup> See HKEX, Issuer Related Information: List of Directors as at 1 December 2017 available at <http://www.hkexnews.hk/reports/dirsearch/dirlist/directorlist.htm>

<sup>3</sup> Directors A, B and C hold 17, 15 and 14 INEDships respectively as at 1 December 2017.

If the objective is indeed to highlight the importance of the office of an INED by emphasizing the need for individuals to commit sufficient time to effectively discharge their duties and responsibilities I would propose that the number be set initially at **FIVE (5)** INEDships.<sup>4</sup> This would expand the ‘net’ to more than the mere 29 individuals to which the proposed amendment to CP A.5.5 would currently apply. More importantly it is my firm belief that the resulting disclosures will serve to further highlight and amplify the importance of the office of INEDs in the promotion of good corporate governance practices.

I also note from my review of the List of Directors that some individuals hold multiple INEDships within a listed corporate group. While this is a factor contributing to overboarding I have elected to address the same under the section titled ‘*Factors Affecting INED’s Independence*’ below which I believe is more appropriate.

## 2. Board diversity

I share the views of the HKEX that ‘diversity encompasses more than simply gender’ and this may be an opportune time to actively promote a better appreciation that – despite the difficulty in objectively quantifying other factors including cultural, educational background and professional experience – diversity is more broad based.<sup>5</sup> More disclosure on the nomination process would enhance the understanding of the importance of board diversity and I **support** the upgrading of CP A.5.6 to a Rule.

Whilst on the broad subject of diversity I would strongly advocate the use of more ‘gender neutral’ language. Although Main Board Listing Rule 1.03 provides that ‘*Where the context so permits or requires, words importing the singular number include the plural and vice versa and words importing the masculine gender include the feminine and neuter genders and vice versa*’ I see no reason why henceforth we cannot adopt the terms ‘they’ and ‘their’ in place of ‘he’ or ‘his’ which is presently used.<sup>6</sup>

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<sup>4</sup> This will make the cap on INEDships in Hong Kong consistent with that of the Mainland: see China Securities Regulatory Commission ‘*Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*’ (16 August 2001) available at [http://www.csrc.gov.cn/pub/csrc\\_en/newsfacts/release/200708/t20070810\\_69191.html](http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69191.html)

<sup>5</sup> When the recent problems at Steinhoff International Holdings NV settle down one could possibly attribute part of these to the lack of diversity in its boardroom: see e.g. MoneyWeb ‘*A Steinhoff lesson: Don’t neglect board diversity*’ (14 December 2017) available at <https://www.moneyweb.co.za/moneyweb-opinion/a-steinhoff-lesson-dont-neglect-board-diversity/> and Sunday Times ‘*Steinhoff debacle shows corporate governance is in a parlous and risky state*’ (10 December 2017) available at <https://www.timeslive.co.za/sunday-times/opinion-and-analysis/2017-12-09-steinhoff-debacle-shows-corporate-governance-is--in-a-parlous-and-risky-state/>

<sup>6</sup> See e.g. The Telegraph ‘*The Old Lady in danger as Bank of England ditches gendered language*’ (13 December 2017) available at <http://www.telegraph.co.uk/business/2017/12/13/old-lady-danger-bank-england-ditches-gendered->

### 3. Factors affecting INED's independence

I am of the opinion that for consistency both Rule 3.13(3) and Rule 3.13(4) as well as CP C.3.2 should be amended to extend the 'cooling off period' to three (3) years. I ***do not*** see why having a material business interest in business activities should be considered any less important than being a former professional adviser in the determination of independence. Furthermore I do not subscribe to the view that 'there is a shortage of potential INEDs in the market' as this casts an unsubstantiated negative view of the quality of independent human capital that we have in Hong Kong. Premised on this belief I am confident that the pool of potential INEDs will not be diminished with the adoption of a 'higher' standard of independence that is on par with the practices in Australia and the United Kingdom.<sup>7</sup>

I ***support*** the adoption of the consideration of cross-directorships similar to that as set out in the HKMA Guidance<sup>8</sup> as a factor in assessing the independence of INEDs. However given its significance I believe that this should more appropriately be a Code Provision with the requirement to 'Comply or Explain' rather than a Recommended Best Practice ("RBP").

While I ***support*** the inclusion of family ties – and its alignment with Rule 14A.12(1)(a) – as a determinant of independence I hold ***no firm views*** on the subject of 'having significant links with other directors'. My principal reservation as regards the latter arises from my being unable to formulate an objective standard against which this can be effectively benchmarked and the resulting absence of a 'universally accepted test' may lead to undesired uncertainties. That said I stand to be corrected if my understanding of the lack of an appropriate test is proven wrong.

However I ***firmly believe*** that holding INEDships in different entities within a listed corporate group should be considered as a factor that immediately undermines independence. I would define a 'listed corporate group' as a structure which would – at a minimum – allow for equity accounting. In short such a listed corporate group would include subsidiaries as well as investee or associate companies.

While such companies may presently be relatively few in number I envisage there to be an increase over time as the more successful companies may opt to spin off various parts of their businesses. It should be obvious that having the same individual as an INED across these

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<sup>7</sup> It should be noted that these are not Rules but 'Comply or Explain' provisions in both jurisdictions: see UK Code B.1.1 and Australian Code Recommendation 2.3.

<sup>8</sup> See Hong Kong Monetary Authority 'Guidance on the Empowerment of INEDs in the Banking Industry in Hong Kong' (December 2016).

companies is problematic when dealing with issues such as related party transactions. I must reiterate that this proposal is not a bar to any individual accepting concurrent directorships within a listed corporate group. However he or she can only be an INED of one of the entities and can therefore only assume the office as a non-executive directorship at the others.

## PART II: NOMINATION POLICY

I **support** this proposal as it enhances transparency of the nomination process to facilitate the attainment of a balance of skills, experience and diversity on boards.

## PART III: DIRECTORS' ATTENDANCE AT MEETINGS

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

As I believe that there is **no ambiguity** with the language as presently set out in CP A.6.7 it must follow that the Frequently Asked Questions (“FAQ”) that was published in March 2013 is incorrect. Given that a key objective of the present consultation is to highlight the fact that INEDs should be cognizant of the time commitments that come with the office their attendance at the general meeting should be part and parcel of any INEDship. This is moreso when one considers that often times the only opportunity that shareholders get to meet their INEDs is during the general meeting. Put another way: How can absence from the general meeting enable the INED to ‘develop a balanced understanding of the views of shareholders’?

Based on the foregoing I would **unequivocally reject** this proposal. Persons who aspire to the office of INEDs should always have in mind the motto ‘*With great power comes great responsibility.*’<sup>9</sup> Thus instead of deleting the last sentence it is the FAQ which should be amended to provide the correct interpretation of CP A.6.7 and enforced accordingly on a ‘Comply or Explain’ basis. It is clear from the random survey conducted by the HKEX in January 2017 that the majority of the listed companies – 57 out of the 100 surveyed – and their INEDs understand their responsibilities which rationale is premised on the practice of good governance. It is therefore incumbent on the HKEX to properly educate the minority of companies as well as their INEDs of the good practices to which they should aspire.

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<sup>9</sup> See e.g. Quote Investigator available at <https://quoteinvestigator.com/2015/07/23/great-power/>

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

Regardless of whether a company practises CEO Duality namely where the roles of the Chairman and of the Chief Executive Officer is performed by the same person it is good practice for there to be regular meetings with the INEDs. I therefore support this proposal with one important caveat namely that the meeting – to be held at least annually – should not be ‘tagged on’ to a board and/or a board committee meeting.

In short there should be a distinct and separate time for this meeting between the Chairman and the INEDs and this should not be scheduled around the convenience of a board meeting. This emphasizes a key objective of this consultation exercise namely that the INED should be fully aware of the considerable time commitments that the office entails and should therefore only accept INEDships in which he or she believes that a positive contribution can be made towards enhancing good governance and practices.

## **PART IV: DIVIDEND POLICY**

While I support this proposal I believe that the disclosure will be more useful and informative if it were set out in a tabular format to facilitate for ease of comparison by shareholders. This will provide a benchmark to allow for more informed decision making as shareholders will be able to immediately note any deviation or variance between the ‘expected’ versus the ‘actual’. In addition due consideration should also be given to requiring the issuer to disclose such information on a ‘rolling basis’ perhaps over the immediate preceding three-year period.

## **PART V: IMPLIED CONSENT FOR ELECTRONIC DISSEMINATION**

Given the current limitations in the *Companies Ordinance* (Cap 622) I would agree with the proposal.