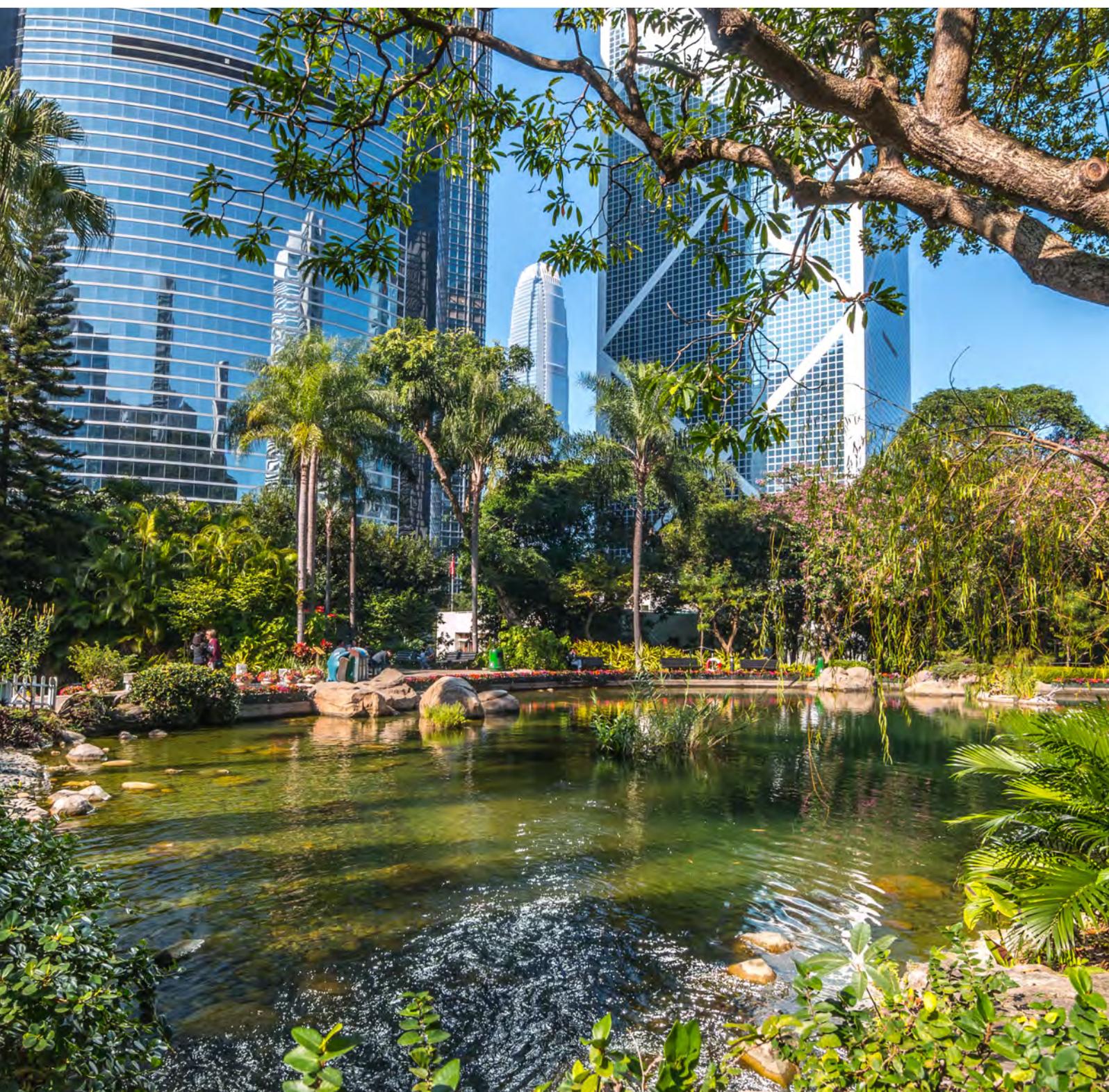


Making inroads into good Corporate Governance and ESG management

Perspectives from industry practitioners



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Message from Head of Listing, HKEX

At Hong Kong Exchanges and Clearing Limited (HKEX) we promote corporate governance and environmental, social and governance (ESG) disclosures and implementation as a way to create a sustainable ecosystem that caters to the unique culture of our local market, while at the same time meeting international standards and expectations. As Asia's largest exchange operator and market regulator, we began introducing various corporate governance standards and ESG reporting guidelines nearly 20 years ago, and they have been evolving ever since. We remain fully committed to the long-term sustainability journey.

The pillars of corporate governance and ESG support our market's quality and reputation, which in turn contributes to HKEX's competitiveness as a global marketplace. Delivery on good corporate governance practices and ESG measures is more than a box-ticking exercise: it is important for issuers to truly appreciate the value of integrating corporate governance and ESG into their strategies and operations. Strong commitment, collaboration and strategic direction from the board is an essential first step for an organisation as it starts its journey. Over the years, we have sought to support the entire issuer community providing directors' webcasts, e-trainings and publishing guidance materials, with the aim of instilling enhanced attitudes towards corporate governance and ESG for HKEX listed companies, and their boards.

Compliance with corporate governance and ESG matters should start ahead of any listing. In July this year, we updated an [IPO guidance letter](#) (GL86-16) to highlight the importance of ensuring that the necessary corporate governance and ESG mechanisms are built into the listing processes, and the need for additional disclosures on certain corporate governance matters. This brochure represents the valuable insight and expertise of experienced market practitioners, who share their knowledge and practical advice on what listing applicants and newly listed companies should focus on when formulating and implementing an effective corporate governance and ESG framework. Together, we will continue to work to enhance the quality of corporate governance and ESG amongst our issuers.

We appreciate the support from Hong Kong Securities and Investment Institute throughout the process of producing this brochure. We would also like to thank all the contributors who drafted the content for the individual chapters.

Bonnie Y Chan
Head of Listing, HKEX

Foreword

We are living in unprecedented times. Acute geopolitical tensions and the outbreak of Covid-19 have highlighted the importance of good corporate governance and environmental, social and governance (ESG) risk management to face such challenges. The role of corporate governance and ESG in investment strategies is fast becoming mainstream, supported by regulators, indices and exchanges. There is increasing evidence that balancing short-term performance with sustainability, transparency and good governance leads to long-term success for issuers and investors alike.

Rules and sanctions clearly can have a place, but on their own they will not deliver behavioural change. The change needs to begin at the top of organisations. This makes the role of the Board more critical than ever, as Boards are expected to drive the corporate governance and ESG agenda of their companies. As primary stewards of risk and guardians of long-term enterprise value, the Board is collectively responsible for ensuring that the necessary mechanisms for corporate governance and ESG are ready prior to any IPO listing process, so that they are up and running immediately upon listing.

In recent years the Exchange has taken significant steps in enhancing its corporate governance and ESG reporting framework, and it will continue to do so as investor and market expectations evolve. This brochure provides practical insights from market practitioners to help directors of listing applicants and newly listed companies think holistically about building and integrating corporate governance and ESG mechanisms into their business strategy, risk management, compliance, and performance to achieve long-term value for their organisations.

Together, we are fully focused on enhancing the governance and ESG standards amongst our issuers for long-term business and economic success. We welcome you in joining us on this journey.

Keith Pogson

Chairman, CG/ESG Standing Sub-committee of the Listing Committee
Deputy Chairman, Listing Committee

Why Corporate Governance and ESG Matter

What is corporate governance?

Corporate governance focuses on a listed company's internal processes and leadership, covering areas such as codes of conduct, audit and internal controls, and shareholder rights. It also encompasses the systems and processes that help manage a listed company's exposure and risks, whether these are financial, reputational, or operational.

What is ESG?

Environmental, Social and Governance (ESG) relates to a listed company's sustainability and its impact on the environment and the wider society within which it operates. It forms part of a listed company's overarching duties in relation to its corporate governance. ESG is increasingly gaining prominence with stakeholders, especially investors, compelling companies to be part of a regenerative economy, and examine how they manage relationships with their employees, suppliers, customers and the communities in which they operate. With investors increasingly assessing companies in terms of their holistic performance, long-term sustainability, and societal impact, ESG cannot be overlooked. As such, companies are now required to assess the social and environmental impacts of their business.

Links between corporate governance and ESG

Corporate governance and ESG are complementary, with corporate governance inextricably linked to good governance of environmental and social issues.

Corporate governance and ESG cover all aspects of a company's business, from day-to-day operations to aspects of commercial viability, including brand and reputation, and stakeholder capitalism. The management of issues relating to how an organisation interacts with the environment, its own people and the communities in which it operates all tie in with how the organisation is governed.

Taken together, corporate governance and ESG demonstrate how a business ought to be managed and operated, while simultaneously taking into consideration environmental and social risks or impacts. Good corporate governance practices are not only a prerequisite for managing ESG issues, but provide the bedrock for managing environmental and social risk and ensuring there is accountability and ownership at the highest level of the business.

The role of the board

The Listing Rules, including the Corporate Governance Code¹ (CG Code) and the ESG Reporting Guide², set out the reporting requirements listed companies are obliged to comply with in this area. They include details relating to the structure and functioning of the board of directors, as well as board leadership and oversight of corporate governance and ESG matters. Ultimately, the board of a listed company has overall responsibility for the company's ESG strategy, reporting and determining the approach management takes in this area.

To discharge its duty to oversee and ensure a business is sustainable and resilient, the board needs to thoroughly understand the company’s environmental and social impacts, and embed ESG factors into the business. As a result, the board must be equipped with the right skills and competencies to make decisions on corporate governance and ESG, ensuring all members have a solid understanding of the related requirements. Upskilling in this area can take a variety of different forms including:

- attending continuing professional development training sessions;
- inviting regular subject matter experts to address the board, particularly on material issues of the business and to provide the board with training;
- appointing new board members with specific corporate governance and ESG expertise, qualifications or experience.

The board may also consider retaining external consultants with relevant expertise to support them.

Top-down structure

The board evaluates and determines the listed company’s ESG-related risks and ensures that appropriate and effective ESG risk management and controls are in place. Only when ESG is championed by the highest authority in a listed company, can it then be integrated into the strategy and risk meetings of the company.

A solid ESG governance system helps a company implement its ESG strategy across the business, manage its goal setting and reporting processes, strengthen relations with external stakeholders, and ensure overall accountability. Commitment at the board level has to be translated to the management and then to the operational teams of the company. The board, as well as a sustainability or ESG committee, also provides strategic direction on material ESG issues, and overseeing their implementation at the operational level. Investor relations professionals should also be involved in this process, just as they would be for other board-level discussions such as risks, audit and business strategy.

Placing ESG in a key position in the listed company’s corporate governance structure is a strong corporate governance practice.

Governance structures that incorporate ESG



Focusing on priorities

Not all ESG topics are required to be discussed or addressed by the board. Instead, it should focus on the topics that it considers to be sufficiently important to the listed company, its investors and other stakeholders, and ESG matters that will have the biggest impact. This is known as materiality, the reporting principle for determining what ESG issues a board addresses and the key to meaningful and concise ESG reporting. Adopting this process can drive improvements in company policies and procedures, increase transparency and offer an opportunity for enhanced stakeholder reengagement, enabling a listed company to shift to a more efficient manner of operating, while driving more sustainable management and overall long-term business success.

Taking action

The adoption and application of ESG considerations is testimony to the fact that they are now globally accepted as being central to a business' success. As a concept, it has moved on from the mindset of 'doing good' through corporate philanthropy and Corporate Social Responsibility communications to genuinely doing good business and being a good company. This approach means recognising risks, not just the usual-cost of labour or market volatility, but risks including environmental vulnerabilities or even social risks. Evaluating ESG risks should be considered a critical aspect of corporate governance practices.

To put this mindset into action and create value, listed companies are encouraged to disclose in the management discussion and analysis sections of their interim/annual reports additional information such as business risks, management policy risks, policies and performance on environmental, community, social, ethical and reputational issues, and key relationships with employees, customers, suppliers and others. In addition, the CG Code details the principles of good corporate governance and obliges listed companies to report on a "comply or explain" basis.

Building resilience

Corporate governance, alongside ESG risk management, not only can future proof a listed company, but can also create a mindset shift towards resilience-building across the business. Corporate governance and ESG require a re-focusing of operational relevance both today and going forward. As changes arise from external developments outside of the company's control, so too must the company's ability to adapt accordingly. Adopting a more corporate governance and ESG-orientated approach can highlight issues of economic, environmental and social sustainability and commercial viability that should be firmly on the agenda and acted upon by the board of a listed company.

For example, a logistics company whose main assets are transport vehicles may be affected if oil prices rise due to policy changes restricting petrol use. It may also be considered a polluting industry and be subject to additional laws, regulations and taxation. Possible future changes to laws or regulations may force the write-off or early retirement of certain vehicles, such as those that run on diesel.

Financial performance may also be affected by changes in water availability and quality, by food security, and by extreme temperature changes affecting a company's premises, operations, supply chain, transport needs, and employee safety. For instance, a beverage company will be affected by changes in water availability. With temperatures rising, a construction company may be more concerned about construction workers' safety when working under the sun, as well as any potential delays caused by extreme weather.

Key stakeholders in the journey

The board of a listed company must make time to engage with the relevant internal stakeholders to understand their areas of concern and focus. These stakeholders include, but are not limited to:

The Board

To ensure appropriate diversity and skills to enable ESG to be well covered

Company Secretary

An internal champion of governance and compliance

Risk Committee

To integrate ESG risk considerations

Investor Relations

To ensure proper communication with investors

Beyond engaging with internal stakeholders, seeking input from external stakeholders such as investors, local community representatives and shareholders can also bring forward additional ESG considerations that may not have been on the board's radar.



“As an electricity utility providing an essential service to the community, CLP has long recognised the importance of managing ESG issues. Doing this well is fundamental to building and maintaining trust with our stakeholders and we believe that building ESG into our corporate governance structures and processes is a value enabler for our organisation and our stakeholders. In these challenging times, an integrated approach to ESG should be seen as an important risk and business management tool. It's more than just reporting.”

Richard Lancaster

Chief Executive Officer of CLP Holdings Limited

Key takeaways

- Corporate governance and ESG are important both pre-IPO and post-IPO as the listed company is answerable to many stakeholders in terms of both the financial and non-financial aspects of its business.
- Investors increasingly want to see evidence that listed companies recognise the importance of ESG factors, as they believe companies with a strong ESG focus deliver greater shareholder value at a lower risk over the long term.
- Listed companies that identify and address ESG-related risks are likely to achieve long-term sustainability and are more likely to be resilient to a changing world and environment.
- The board should conduct an internal review to ensure they have the appropriate skills, policies and practices to track and manage ESG at the level that is now required of a listed company.
- As the board of the listed company maintains the overall responsibility for corporate governance and ESG matters, having a sound corporate governance structure and oversight mechanism to re-evaluate traditional operational approaches can assist the organisation in aligning its business strategy with the global economic and climate outlook.

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Issues to Consider When Preparing for an IPO

Corporate governance and ESG factors are increasingly important for boards planning an IPO. With pressure from regulators, investors, the media and climate activists mounting, boards need to pay attention to factors such as board diversity, sustainability and climate impact to create an attractive equity story.

Focusing on these factors at an early stage can bring additional benefits, including higher staff morale, an improved standing with customers and suppliers, and potentially avoiding negative publicity.

1. Board diversity

An IPO creates the opportunity to broaden the outlook and experience of the executive directors (EDs), who are responsible for the growth and development of a listed company. EDs are normally drawn from the heads of divisions or business sectors, with the addition of a finance director and sometimes a legal counsel or company secretary. They may form a small, tight-knit group with limited diversity. As a result, the choice of independent non-executive directors (INEDs) plays a critical role.

There has been a growing focus on board diversity, in particular on gender diversity. Greater diversity promotes board effectiveness and enable better decisions due to the lessened risk of groupthink. All listed companies are required to have a board diversity policy. For IPO applicants with single gender board, additional disclosures are required in the prospectus on how gender diversity of the board can be achieved, including the measurable objectives set for implementing gender diversity. The Exchange observed that most of the newly listed single gender board companies have committed to appointing at least one female director within two to three years after IPO, and the Exchange will continue to monitor their progress.

The role of INEDs

INEDs are expected to give strategic advice on the listed company's long-term development, and act in the best interests of the company. They are ideally placed to make potentially controversial recommendations to senior management. Even so, INEDs must maintain a strong working relationship and good communication with management so that their ideas can be conveyed clearly and be carried out effectively.

The background of INEDS

The Listing Rules require that at least one INED has a financial background. Companies are also encouraged to appoint INEDs who are knowledgeable about the industry in which the listed company is operating. INEDs with experience of good administrative practices, such as former civil servants or academics, also make a useful contribution. Fresh thinking could be supplied by a recently retired Chief Executive Officer (CEO) in a similar industry, while groups with overseas ambitions may wish to tap into executives of international standing who may help to open doors in new markets.

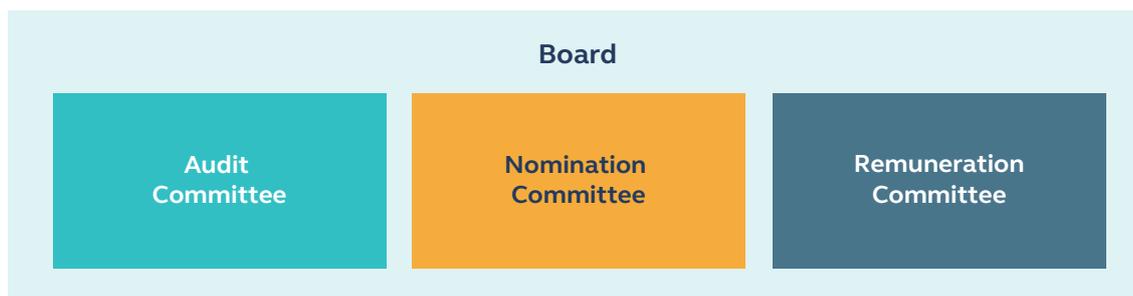
Why it matters

Sponsors and investors look for INEDs who are able to stand back and view critical decisions from a different perspective. For example, an INED of this calibre might have helped Boeing evaluate its approach to the 737 Max problems or Rio Tinto realise the risks of mining on traditional aboriginal sites. If a listed company is planning a fundamental shift in operations, such as from traditional retailing to e-commerce, an INED with an IT or new economy background would increase sponsors' and investors' confidence that the strategy would be properly evaluated at board level. An INED with a strong reputation is also unlikely to risk their standing by being too amenable or susceptible to pressure, on such matters as connected transactions or dividend payments.

Finding the right INEDs

Larger groups may employ consultants to identify suitable INEDs, but many INEDs are chosen because they are already known to the existing controlling shareholders and directors. While this practice may be almost inevitable in the case of a small company, where it is unlikely that INEDs with no past knowledge of the controlling shareholder and business would be prepared to serve, it may create some doubt in investors' minds as to whether the INEDs are sufficiently independent. The EDs should also consider the need to provide competent chairs for the various board committees, as the chair often has a determining influence on the effectiveness of the committee.

2. Board committees



Audit Committee

The audit committee must be chaired by an INED with relevant experience, usually a practising accountant from a small firm or a retired partner from a large firm. The audit committee is often the most active committee and the need to have an experienced and capable chairman puts pressure on the pool of candidates available in Hong Kong. This situation can lead to so-called overboarding – INEDs with more than six directorships – resulting in a concentration of work during interim and final results, as many listed companies have the same 31 December year end.

Nomination Committee

The nomination committee is responsible for evaluating existing directors' performance and developing a credible and specific succession plan for key management positions. Succession planning is a difficult area, even in large corporations, as a strong CEO may be reluctant to groom a successor and it may fall to the nomination committee to exercise some (tactful) pressure. Succession planning should go beyond the board of the listed company to include the boards of key operating subsidiaries and

senior management generally. The nomination committee also reviews whether retiring directors of the listed company should be re-appointed. INEDs play an important role helping to ease tensions as a listed company transitions from a founder-dominated culture to a more arm's length management style.

Remuneration Committee

The remuneration committee has the sensitive job of considering the pay levels of senior management. Another controversial aspect can be the introduction and terms of share incentive schemes for senior management. Remuneration consultants may be hired to provide industry comparisons and establish benchmarks to be achieved.

The effectiveness of these committees is heavily dependent on the capabilities of the chair, who is usually an INED. Experience of chairing discussions and encouraging committees to reach decisions is a valuable asset in this role. The listed company may consider appointing directors from diverse backgrounds and with independent views at an early stage of preparation for an IPO, as doing so can improve corporate governance and help to attract pre-IPO investors.

3. Chairman and CEO

The CG Code states that the roles of chairman and CEO should be separate and should not be performed by the same individual. This separation is fundamental to how a board approaches its task. In private groups, however, it is unlikely that the role of chairman will be separate from that of CEO, and the founder/CEO may be reluctant to change this practice upon listing.

The role of an experienced and independent chairman can be particularly valuable in a relatively large group where bringing together disparate views is critical. However, in a smaller more focussed group, the EDs are likely to have their particular spheres of influence/expertise and the founder/senior ED will take on the role of chairman. Having an independent chairman increases investors' confidence that board discussions will be conducted objectively and diverging opinions listened to. Board committees could be chaired by the INEDs, not the chairman/CEO. For a newly listed company in Hong Kong, the presence of INEDs may mitigate the power of the chairman/CEO, particularly as parachuting in a new chairman before an IPO may lead to tensions with the CEO.

The key question is how investors will respond if these two roles are not separated. The issue may not be as important to investors as growth and cash flow at the time of an IPO. However, they may be concerned about how the listed company will cope if the management team needs to change course or encounters reputational challenges further down the line.



4. Company secretary and compliance adviser

The company secretary and the compliance adviser both play key roles in maintaining good corporate governance at a listed company. (See Chapter 5 for further details on how a listed company can derive the most benefit from the support of these professionals.)

The company secretary

The company secretary plays an important role in keeping directors fully informed, convening meetings where appropriate and keeping full and accurate records. While company secretaries must have appropriate professional qualifications and experience, an outside appointment may lack detailed knowledge of the listed company and its culture. Two joint company secretaries can be appointed for the first three years, one being an outside professional and one an internal administrator, to overcome this issue. In the case of an 'A' share company listing its 'H' shares in Hong Kong, such a move will be necessary in any event. After the internal appointee has gained the necessary experience, they may be appointed sole company secretary.

The compliance adviser

A compliance adviser is required under the Listing Rules.³ The terms of appointment of the compliance adviser should be agreed and signed before the submission of the formal application for listing, so up to two to three months before the start of trading, although the formal role (and the fee) does not begin until trading actually starts. The role continues until the publication of the accounts for the first full year after flotation. As a result, for a company with a year end of December, floating in say October/November, this will be a period of about 18 months.

³ See Main Board Listing Rule 3A.19 to 3A.30 / GEM Listing Rules 6A.19 to 6A.30 for further details of the responsibilities of the compliance adviser and the listed company.

There are sharply diverging attitudes among directors to compliance advisers, with some regarding this role as largely superfluous, not required by other international exchanges, and increasing listing expense, particularly as directors undergo training on the Listing Rules and, as experienced executives, should be capable of understanding them. As a result, in some companies the role is terminated as soon as the required period expires.

It is not always easy to understand the full implications of complex Listing Rules, particularly on connected transactions, before experiencing them. As directors are often pre-occupied in delivering performance after the IPO, the burden of ensuring a newly listed company and its directors follow through on statements in the prospectus and comply with the Listing Rules can fall heavily on the company secretary and CFO. The compliance adviser can provide a valuable second opinion, for example on a potentially controversial disclosure, or sometimes just a shoulder to cry on! An early connected transaction can easily be missed or caps established for continuing connected transactions can be exceeded if the company lacks experience. Increasingly, the role of the compliance adviser is extended beyond the initial term.

5. Why do investors care?

Paying greater attention to environmental factors and other aspects of good governance are increasingly important criteria for investors when they make their investment decisions. Fund managers are now regularly faced with questions about how they approach and measure the corporate governance and ESG aspects of their investee companies. Many institutional investors have set up dedicated corporate governance and ESG teams and seek to drive change through participating in shareholder meetings and holding direct discussion with their investees' management.

While corporate governance and ESG may be only one of many factors that affect an investment decision, they have proved to be critical in some cases. For example, a reputable private equity firm decided not to invest in an electronic vaporiser manufacturer over ESG concerns. One of the many lessons from the WeWork saga is that corporate governance does matter, with concerns about leadership accountability, oversight and conflicts of interest deterring potential investors. In Hong Kong, the Hong Kong Monetary Authority, as the manager of the Exchange Fund, has integrated ESG factors into its investment process as a way to mitigate risks and enhance long-term returns.

As institutional investors assign more weight to these factors, it becomes necessary for the listed company's board to assess how the company's rating on matters such as the diversity of its directors and its climate impact policies will influence demand for its shares.



Due diligence during the IPO

The board should note that during the IPO process, sponsors are required to conduct due diligence on the company, which includes the company's corporate governance framework and internal controls system. An external consultant is usually engaged for this purpose to ascertain whether the company has established an adequate corporate governance framework (i.e. procedures, systems and controls) that complies with the relevant requirements under the Listing Rules and other relevant legal, regulatory and public expectations, as well as to provide recommendations to strengthen existing processes. The exercise is typically known as "pre-listing internal controls assistance in relation to Hong Kong listing application (PN21 engagement)".

ESG should be built into the company's initiatives to strengthen its corporate governance framework and policies. Integrating ESG risk management (including identifying material ESG risks and managing such risks) into the company's corporate governance initiatives is a key pillar of a comprehensive corporate governance framework. It is important for the board to ensure ESG drivers are incorporated into the board's agenda and strategy. As such, the same external consultant is often asked to also assess and advise on the board's approach and implementation of ESG policies. This approach can ensure alignment of the corporate governance and ESG framework, and leverage economies-of-scale by using the same expert.

Key takeaways

- It is critical for listed companies to embed sound corporate governance and ESG policies into the IPO process. Greater focus on corporate governance and ESG policies can reap long-lasting benefits for a newly listed company.
- Appointing INEDs with key industry experience and administrative skills helps to increase investor confidence. INEDs can have a positive impact on the audit, remuneration and nomination committees.
- The CG Code states that the roles of chairman and CEO should be separate. Notwithstanding the challenges for a small group, the benefits of appointing an independent chairman can be seen over the long term.
- The company secretary and the compliance adviser both play key roles in ensuring good corporate governance remains a priority after the IPO.

Acknowledgements

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What to Expect from INEDs

INEDs play an important role in enhancing the standards of corporate governance at a listed company, guarding against conflicts of interest, assisting with oversight of internal controls and risk management and acting as a catalyst for ESG adoption.

Listing Rules stipulate that listed companies must appoint INEDs to at least one third of board seats, with a minimum of three INEDs required. Directors, whether executive or non-executive, are subject to the same legal duty under the law and the Listing Rules, and are collectively and individually responsible for the management and operations of a listed company.

INEDs in practice

1. General principles



Appointment

Before appointment, an INED candidate should learn, preferably through meeting the chairman, other board members and the CEO, about how the board is organised and operates, the major challenges and issues faced by the company, expectations of INEDs and how they may fit in and add value.

Both listed and non-listed companies can benefit from having outside directors on the board. Engaging INEDs on the board at least one year ahead of filing the Listing Application Form will strengthen board dynamics during IPO preparation and enhance the company's track record of corporate governance.



The board's collective roles

The board is ultimately responsible for corporate governance. All directors, including EDs, non-executive directors (NEDs) and INEDs, bear equal responsibility for fostering the company's long-term success. Collectively, the board is responsible for supervising management, directing the company and accountability.

It is axiomatic that every director must act towards the company with honesty, integrity and candour and exercise due care, skill and diligence. While serving from an independent perspective, INEDs should participate in the board as a contributing team member.

“Today's INED act as a catalyst for ESG adoption by the board and company. Their successes include ensuring ESG subjects are regularly on the board's agenda, promoting extensive in-company training and applying ESG initiatives to daily operations.”

Dr. The Hon Moses Cheng Mo-chi

Founding Chairman of The Hong Kong Institute of Directors



Independent checks and balances

The independence of INEDs is defined by regulation in relation to material interests in business activities or significant links. In addition, independence is an attitude that reveals itself in addressing the company’s business and affairs with an objective perspective and independent judgment, free from the influence of any interests. One can be independent and remain a supportive member of the board by maintaining critical but constructive objectivity.

Exercising checks and balances from an independent perspective, INEDs must ensure the interests of all shareholders, and not only the interests of a particular faction or group, are considered by the board. There are, however, exceptions to the above in transactions, such as takeovers, spin-offs, connected transactions and where INEDs serve on an independent board committee charged with protecting the interests of independent shareholders.



Devoting sufficient time

An INED must be able to afford to devote the time realistically required to familiarise themselves with the company, attend board and committee meetings, review board papers and relevant materials prior to meetings and communicate with the board chairman and management on significant matters.

An INED must exercise judgment to avoid overboarding. Although INEDs appointed to more than six boards must explain how they have the necessary time available to devote to each one, INEDs on fewer boards should also make an honest personal assessment of their time.



Education on evolving governance

INEDs should keep up to date with evolving governance and learn how to stimulate board discussions on issues such as enhancing governance standards (noting investors are ready to pay a premium for good governance). They should put equal emphasis on conformance and performance, as well as understand the rise of ESG reporting and the expansion of shareholder rights, along with the growing importance of institutional investors. Continuing education and training help to both empower INEDs in their roles and enlighten other board members and management on how best to work with INEDs.



Interest segregation

As an INED may have many outside interests, it is pertinent and necessary to disclose all relevant interests to the board and refrain from discussing and voting on matters with actual and potential conflicts of interest.



2. Practical aspects



Participating effectively

INEDs can add value to the board through being inquisitive in questioning assumptions and motivating the board to see issues in a new or different way. They can also provide input from general and/or specialist knowledge and outside information. INEDs can assume multi-dimensional roles, such as facilitator, catalyst, sounding board, and networker.



Risk management

INEDs are well positioned to address enterprise risk management from both an insider and an outsider perspective. Risk management calls for the careful review of risk strategy, including risk appetite, risk governance and culture, risk assessments, mitigation and monitoring. Risk management also involves examining the effectiveness of the three lines of defence: the functions that own and manage risk, the functions that oversee or specialise in risk management and the functions that provide independent assurance, i.e. internal audit, while the risk list covers financial risks, operational risks and reputational risks.



Scrutinising internal control

INEDs should make sure a robust system of internal control is in place to ensure the company's operational effectiveness and efficiency, reliable financial reporting and compliance with laws and regulations. In particular, INEDs should exercise scrutiny over the internal controls that prevent, detect and correct errors and irregularities.

INEDs should also ensure the proper functioning of internal audit, performed by internal staff or an external professional adviser. Internal auditors report independently to the audit committee and/or board, not management, to assist in oversight of the company's system of risk management and internal controls.



Shareholder relations

INEDs also play an important role in shareholder relations. It is an INED's duty to attend general meetings to understand their concerns and issues. INEDs should exercise due care in reviewing the company's announcements and reports to shareholders before publication. They are also at times required to meet investors, particularly on occasions of special transactions.

“ INEDs play a significant role by acting independently, guarding against conflicts of interests and ensuring proper corporate conduct. In contributing to shaping overall development, INEDs must be seasoned in assessing the business landscape and risks, particularly when the company engages in a major transaction or explores a new line of business. ”

Dr. David Wong Yau-kar

Past Deputy Chairman of The Hong Kong Institute of Directors



Sustainability

Corporate sustainability is communicated through ESG reporting, which is an evolving practice. INEDs should champion the ESG cause to the board, promoting board leadership in ESG adoption and ensuring management takes it to heart.

INEDs may draw the board's attention to the drivers for ESG adoption, such as opportunities for operational efficiency, new products and innovation, enhanced risk management, talent attraction and retention, rapid growth of green bond market and sustainability indices, and improved reputation.

The board's checklist for ESG implementation should include environmental impact and green policy, stakeholder issues covering supply chain conformance, employee relations, product responsibility, as well as anti-corruption measures. INEDs should be alert to the "materiality", "quantitative", "consistency" and "balance" principles in ESG reporting.



Working on key committees of the board

The key committees where INEDs play a pivotal role are the audit committee, nomination committee and remuneration committee, all of which should be composed of a majority of INEDs⁴.

INEDs should interact in meetings with management, the external auditor, internal auditor and external consultants. Private meetings of the audit committee with auditors are convened not only according to regular schedules but also when the need arises.

INEDs should ask for further management reports when the need arises, for clarification and as a basis for decision-making. They also have the prerogative to initiate independent studies of special issues through engaging external advisers.



Working on the ESG committee of the board

An ESG committee, though not mandatory, helps a listed company ensure its ESG implementation is keeping pace with external trends. INEDs may add value to the board by taking an active part in ESG committee.



⁴ Listing Rule requirements

- Audit committee: composed of NEDs only, majority INEDs, chaired by INED.
- Nomination committee: majority INEDs, chaired by INED or chairman of the board.
- Remuneration committee: majority INEDs, chaired by INED.

3. Working with INEDs

In a two-way relationship, EDs, NEDs and management should ensure that INEDs are included, integrated, motivated, empowered and able to work. The board chairman should take the lead in cultivating the right attitude and work relationship with INEDs. The board chairman should also conduct private sessions, apart from the mandatory annual session, with INEDs to discuss major issues and any concerns.

The company should offer reasonable remuneration and coverage of Directors and Officers Liability Insurance to INEDs, as well as arranging for their induction, continuing education and updates on directors' duties.



INEDs should be given reasonable time to review papers before meetings and have significant reports before they are announced. Management should also proactively communicate with INEDs, giving timely alerts about crises and briefings on significant issues and new proposals.

The company should invite INEDs to participate in major events and stakeholder engagements, and provide INEDs with independent professional advice upon special circumstances and as requested by INEDs, at the company's own expense.

It takes the whole board and management, working together, to realise the value of INEDs.

“Going forward, we will see a paradigm shift in INED's focus to include both financial and ESG performance, and a move from independence to interdependence and interplay among INEDs, NEDs and EDs.”

Dr. Kelvin Wong Tin-yau

Past Chairman of The Hong Kong Institute of Directors

Key takeaways

- INEDs play an important role in enhancing the standards of corporate governance at a listed company, guarding against conflicts of interest, assisting with oversight of internal controls and risk management and acting as a catalyst for ESG adoption.
- Continuing education and training help to both empower INEDs in their roles and enlighten other board members and management on how best to work with INEDs.
- INEDs play an important role in shareholder relations and have a duty to attend general meetings.
- INEDs play a pivotal role in the audit committee, nomination committee and remuneration committee.

Acknowledgements

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The Role of Reporting Accountants

The primary role of reporting accountants in a listing application is to say whether the financial statements of the applicant give a true and fair view of its results and financial position for the reporting period. The reporting accountants also have a responsibility under the Hong Kong Standard on Investment Circular Reporting 500 (HKSIR 500) to report on the listing applicant's profit forecast, statement of sufficiency of working capital and statement of indebtedness – whichever is reported by the applicant.

External auditors will also review the corporate governance and internal controls of the listing applicant to make sure sufficient management controls are in place to enable the preparation of true and fair financial statements. However, the due diligence on the adequacy of the procedures, systems and controls (including accounting and management systems) will be conducted by an adviser engaged for this purpose, which is covered in Chapter 2.

Focus on ESG

There is an increasing focus on how ESG matters may give rise to financial impacts. As topics such as climate change and social impact gain prominence and come under increased scrutiny from different stakeholders, there is a heightened risk that new regulations could be introduced that may potentially impact the financial statements of listing applicants.

As required by the HKEX's revised guidance letter GL86-16, ESG-related matters should also be considered in the business section of the listing applicant's prospectus. As the prospectus must be considered in its entirety, it is advisable for listing applicants to consider whether these ESG matters also need to be included in other sections of the prospectus.

For example, listing applicants should consider the need to include in the risk factors statement such ESG and related matters set out in the business section of the prospectus. The correlation between ESG and related matters and the accounting judgements, estimates, financial risk management and fair value disclosures in the financial statements will also need to be considered.

Listing applicants are required to put in place the required corporate governance and ESG mechanisms prior to listing to ensure they are compliant with the Listing Rules upon listing, and that corporate governance and ESG are firmly embedded in the overall governance structure of the listed company.



Impact on impairment and asset carrying values

Although ESG is considered to be non-financial information, it is important to understand that it may have a financial impact on a listing applicant. The board of directors of listing applicants, therefore, need to take this into account when preparing the financial statements. Reporting accountants will also need to ensure that these impacts have been fully considered in the financial statements.

Example: Impairment of an asset through climate change-related transition risk

A coal fired power plant was built 10 years ago and has an expected useful life of 50 years. The government is committed to decarbonising the energy sector and this coal fired power plant is therefore expected to be retired early, for example in 15 years' time. The useful life of the asset has therefore been halved to 25 years. In this instance, management will have to consider whether the current carrying value of the asset is accurate and whether an impairment charge is needed.

Example: Impairment of an asset through climate change-related physical risk

A real estate company has a number of commercial properties near the shorefront in a major city. This city has been affected by an increased number of typhoons in recent years, leading to a heightened flood risk due to storm surges. Flood risk is expected to increase further as a result of forecast rises to sea levels. As such, the assets of the company may be impaired as a result of climate change and its related physical risks.

It is important to note that climate change is not the only ESG risk that can have a financial impact on the carrying value of assets. The broader risks associated with ESG also need to be taken into account.

Example: Impairment of an asset through other ESG risks

A food and beverage company operates a cold storage facility which supplies supermarkets and its own restaurants. Recent inspections by the food and environmental hygiene department have indicated several lapses in procedures and equipment malfunctions that could lead to frozen foods being contaminated. As a result, the carrying value of its inventory in this facility will be affected. In addition, it may also potentially face claims from clients if any of these products have already been delivered, impacting future sales projections in its wholesale and restaurant businesses. If the company is required to upgrade equipment at its cold storage facility within 12 months from the date of the prospectus, such expenditure will also need to be included in the statement of the sufficiency of working capital.

In all of the above examples, the decisions and estimates made by management, and the related disclosures, such as in the accounting judgements and estimates, will have to be discussed with the reporting accountants.



Risk statement, business, industry and regulatory overview

Although the reporting accountants do not give an opinion on the remainder of the prospectus, they do consider disclosures made in the prospectus, and assess whether there are any material inconsistencies with their own understanding, as part of the procedure they go through in forming an opinion of the financial statements.

Information on health, work safety, and social and environmental matters is often included in the business section of the prospectus. It is important to assess the completeness of ESG and related matters and discuss with the reporting accountants whether or not these matters could impact the financial statements.

ESG matters which are included in the business section of the prospectus may also give rise to disclosures in the industry and regulatory overview section of the prospectus. This in turn may have an impact on the long-term outlook, useful life and carrying value of assets in the financial statements.

Example: ESG matters that may be included in the industry overview

An automotive parts manufacturer in China is a supplier for internal combustion engine cars. With China's policy moving towards decarbonising the transport sector, it is expected that internal combustion engine cars will be phased out and be replaced with electric and hydrogen combustion engine cars. The manufacturer will have to transform its business to support electric or hydrogen cars. As a result, it may have to prematurely retire its existing production lines, while investing in alternative production lines to ensure it evolves and remains relevant.

Example: ESG matters that may be included in the regulatory overview

A computer gaming company derives most of its revenue from online games in China. Following a decision by the World Health Organisation to categorise computer gaming addiction as an official disease, the Chinese government has reduced the number of online computer game licenses issued annually. This reduction will affect the future revenue of the gaming company and may lead to delays in the release of future games, affecting the future projected revenue stream for games under development.

It is important to note that ESG issues also significantly affect technology companies due to the potential negative impact technology could have on society. As the technological landscape evolves, and technology changes how society operates and behaves, government and regulatory intervention could increase. Recent examples include the way ride hailing apps like Uber have had their licenses revoked in certain jurisdictions due to fake licenses and safety concerns⁵. In addition, consumers may stop using a company's services due to the negative impact on society. An example would be the recent customer boycott of Facebook due to issues with fake news and hate speech⁶.

Key takeaways

- ESG matters can have a significant impact on the financial statements of a listing applicant.
- ESG matters touch on many aspects of a prospectus and the reporting accountants will assess whether these issues have been fully reflected in the financial statements of the listing applicant.
- Given the changing global environment with regards to ESG and the associated changes to the respective industry and regulatory landscapes, reporting accountants are increasingly connecting non-financial information to financial statements.
- It is important for the board of a listing applicant to ensure that the ESG and related matters are comprehensively taken into account when preparing the financial statements and other disclosures in the prospectus.

Acknowledgments

Author:

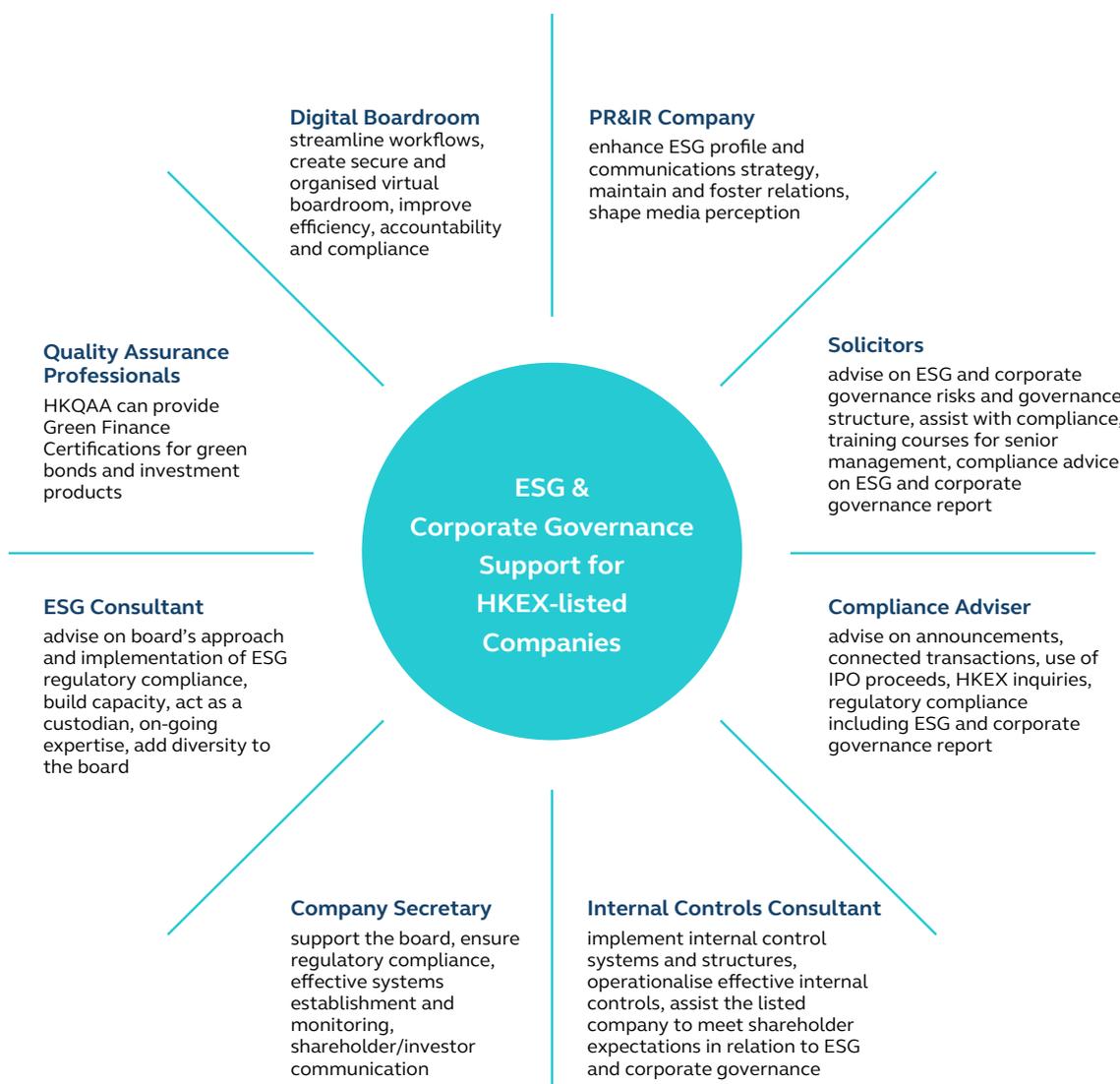
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⁵ <https://www.theguardian.com/technology/2019/nov/25/uber-loses-licence-london-tfl>

⁶ <https://www.forbes.com/sites/jemimamcevoy/2020/07/30/facebook-ad-boycott-extends-beyond-july-everyone-agrees-facebook-has-got-to-change/>

The Value of Outside Advisers

A range of professionals can contribute to a listed company from a corporate governance and ESG perspective. In addition to the roles discussed below, there are a number of other professionals who can also assist, including competent persons and valuers. However, deriving the most benefit from professional services requires a high level of engagement from the listed company and an understanding of how to interact with these professionals.



Company secretary

Eirene Yeung, Executive Committee Member, and Company Secretary of the company secretarial department of CK Asset Holdings Limited, explains: “A company secretary is not a figure a board of directors would usually flash and show to other people, but when something goes wrong, a good company secretary can save the day by demonstrating that a sound and vigorously followed control mechanism is in place.”

All listed companies must appoint and maintain a company secretary (CS). The key role that a CS plays within the governance structure of a listed company is recognised in the CG Code.

Corporate governance, risk management, and disclosure obligations all form part of the traditional role of the CS. A good CS not only supports the board and ensures regulatory compliance, the CS also facilitates shareholders’ and investors’ communications, and is responsible for the induction and professional development of directors. The areas of know-your-client and anti-money laundering also fall within the role of the CS. In recent years, the responsibilities of the CS have become increasingly more complex in light of the rising demands of regulators and new challenges in the macro environment. However, as Yeung remarks, some aspects of the CS’s role are often overlooked, until something goes wrong and it becomes clear that these areas are best placed as part of the CS’s remit. In such circumstances, the forethought and planning of the CS may prove extremely valuable.

The role and importance of the CS in relation to corporate governance and ESG are often understated. Instead of being perceived as a cost centre and a back office, the company secretarial department should be seen as a profit centre that can add value to a company and contribute to corporate success. The CS can play a vital role in supporting the board in its strategic and corporate decision-making process, provided due weight and importance are given to the role of the CS within the listed company. However,

as Yeung remarks, the extent of the support and protection that a CS can offer the board will depend on whether the board of the listed company recognises the ability of the CS in this area, and whether the CS is empowered with corresponding authority and powers.

Examples where a CS can create value include involvement in mergers and acquisitions, joint ventures, financing and other business and strategic decisions. With an in-depth knowledge of the company, the CS can provide useful insights and offer a different perspective that optimises the concerted output, especially if the board proactively involves them at an early stage.

Yeung notes that a CS who grows with a listed company is akin to a ‘walking encyclopedia’ encompassing a diverse array of facts, cultures and strategies concerning the organisation, its businesses and its people, which is highly valuable to the board.

Yeung concludes that to thrive in performance and be effective in execution, a CS must be able to feel at home within the listed company, so that when the storm comes, the CS can take initiatives and demonstrate his or her full potential unreservedly to protect the company.

Internal controls

The board of a listed company must maintain appropriate risk management and internal control systems, the effectiveness of which should be reviewed annually.

Sean Lam, the Senior Managing Director at FTI Consulting, is of the view that internal controls consultants can assist listed companies in designing and implementing effective internal control systems and procedures to meet their obligations under the Listing Rules. They can help address issues such as the reliability of financial reporting, and ensure compliance with the applicable laws and regulations.

Lam explains that although the existing Listing Rule framework is reasonably well-defined and comprehensive, there is no 'one size fits all' approach to its application to real life businesses. The listed company can also benefit from the internal controls consultant's professional insight and judgment, applying their technical expertise and practical experience to assisting management in operationalising effective internal controls.

After the completion of an IPO, an internal controls consultant can have an ongoing role assisting the listed company in refining its existing internal control systems and procedures to keep up with evolving business needs. It is common for newly listed companies to be faced with new and unanticipated opportunities and challenges, such as an expanded organisational structure, entry into new markets and heightened shareholder expectations regarding corporate governance and ESG. As a result, listed companies need to continuously enhance their existing procedures, systems and controls.

There are also various ways in which an internal controls consultant can add value beyond the IPO process, including implementing periodic controls and risk assessments to identify 'gaps' in the existing governance framework, helping facilitate continuous improvement. In the context of an M&A transaction, an internal controls consultant can advise listed companies on integration execution to ensure that the overall control environment and procedures are consistent throughout the combined businesses.

The role of an internal controls consultant continues to evolve in response to the business and regulatory changes of the listed company. The board of a listed company must recognise that an internal controls consultant can support it in adopting a more strategic and proactive approach to corporate governance and internal controls, not only because of their obligations under the Listing Rules, but also because they hold the potential to add significant value to a listed company, contributing to its financial success.

ESG consultants

The overall responsibility of a listed company's ESG strategy and reporting starts with the board. Given the increasing interest of investors and stakeholders in the importance of corporate governance and ESG, an ESG consultant is an invaluable asset to the board, especially given corporate governance and ESG reporting obligations under the Listing Rules.

Patricia Dwyer, Founder and Director of The Purpose Business, explains the core roles of an ESG consultant in supporting the board:

Raise awareness

Ensure that the board stays on top of all listing and compliance requirements, share best practice from peers and highlight to the board imminent regulations on ESG issues and trends that may affect the listed company.

Build capacity

Build capacity within the board or leadership team to prepare them to take accountability and ownership for ESG-related matters. This may include setting up an ESG committee under the risk committee, creating governance and reporting structures and ensuring that regular training is made available.

Act as the custodian

ESG may be too new to be fully understood or owned at board level (at least for the first few years), and as such, the ESG consultant could serve as the objective convenor of all discussions on sustainability.

ESG consultants may be able to add value well beyond advising a listed company around ESG reporting obligations. Dwyer explains that ESG consultants are likely to come from different backgrounds that are not necessarily represented on the board. As such, they may be able to provide the board with different perspectives on issues that would otherwise be viewed through a 'board only' lens. This could include an NGO lens, innovation or enterprise experience, or an academic and regulatory view. These are clearly all highly valuable in adding to the diversity of board experience and expertise.

Dwyer adds that if the board engages an ESG consultant to function as an in-house ESG expert – i.e. contracted on a retained service and part of the internal team – they can provide ongoing expertise, knowledge and technical understanding of ESG-related issues that may influence operational decisions. If the ESG consultant is contracted only for specific deliverables – such as preparing the annual sustainability report or conducting specific trainings – then they would not be as influential in daily operations.

Compliance advisers

A listed company is required to retain a compliance adviser for the period commencing on the date of listing and ending on the publication of its financial results for the first full financial year after listing. The role of the compliance adviser is to advise the company on the following areas:

1. Before publication of any regulatory announcement, circular or financial report;
2. If a notifiable or connected transaction is contemplated;
3. If the listed company proposes to use the proceeds of the IPO in a way other than as detailed in the listing document or where the business activities, developments or results of the company deviate from any forecast, estimate, or other information in the listing document;
4. If the HKEX makes an inquiry to the listed company about movements in the price or trading volume of its securities.

Arnold Ip, the executive director of Altus Capital Limited, emphasises that for the compliance adviser's role to work effectively and add value to the board of a listed company, the board must recognise the need for a healthy relationship between the compliance adviser and itself. The board of the listed company must have a proper corporate governance mindset, and not see the compliance adviser as a financial burden or only as someone to consult when they are questioned by the HKEX.

Where the compliance adviser is willing to advise and support and the listed company is willing to take advice, the standard of governance and the quality of management can be improved. That said, while a compliance adviser can explain the Listing Rule requirements which affect the listed company, they cannot be expected, for example, to know what investor expectations may be, and to advise the board on matters that involve commercial judgment.

For the listed company to derive value from its compliance adviser, the board has to take the initiative on matters that involve commercial decisions. Ip gives the example of where a listed company decides to invest in securities after listing. If it informs its compliance adviser, they can advise the board on the setting up of an investment committee and the corresponding formulation of proper procedures. The board should not lose sight of the business benefits and risks of investing when establishing such functions and procedures. To really benefit from the appointment, the board of the listed company must be wholeheartedly involved, which includes making business judgements where appropriate, and not just looking to the compliance adviser as a party that can provide all encompassing advice that extends beyond issues of regulatory compliance.

Solicitors

Following listing, most newly listed companies continue to use the Hong Kong solicitors who advised the company on its IPO. Some listed companies have an annual “retainer” with a Hong Kong solicitors’ firm which covers advising them on compliance with the Listing Rules and applicable laws and regulations over the course of the year. It may also include providing updates and briefings on changes to the law and policy on corporate governance and ESG, as well as offering training sessions for the board and senior management on a regular basis.

To maximise the value that solicitors can bring to a listed group, the management should keep their solicitors up to date on the group’s corporate governance and ESG aims and strategy, and the challenges it faces. It is important to ensure solicitors are involved early on, so that their comments and suggestions can be carefully considered and fully implemented, and the company is not forced to do only the bare minimum to achieve compliance due to time constraints.

Hong Kong solicitors can also provide a more value-added role in relation to corporate governance and ESG structures and reporting through not only advising listed companies on the establishment of the requisite committees, but also reviewing the running of, and reporting by, these committees and their overall status and function within the group, including for ESG reporting and responsibilities. In addition, solicitors can advise on the optimum structures, reporting lines and responsibilities of the relevant individuals tasked with implementing ESG strategy and reporting requirements.



Listed companies should periodically review and refresh the policies and procedures adopted on or prior to their IPO. Some Hong Kong solicitors’ firms can assist in this task through conducting legal and compliance audits of corporate governance and ESG policies and reporting. Working with the company secretary, in-house legal counsel or other management responsible for corporate governance and ESG compliance issues, Hong Kong solicitors can also provide objective insights gained from working with other listed groups, including helping the group raise its profile with investors interested in green and ecologically-focused investments, facilitating further capital-raising such as through the issuance of green bonds.

Public relations consultant

Public relations consultant can enhance a listed company’s corporate governance and ESG communication strategy, maintain and foster relations, enhance the company’s profile and shape the media’s perception of it. (See Chapter 6 for further details on how a listed company can derive the most benefit from the support of public relations consultant.)

The digital boardroom

The timely production of board and committee papers, the orderly keeping of agendas, minutes and agreements are an integral part of good corporate governance and ESG. Digital board portals allow boards to collect and catalogue board papers in a secure online environment.

As we rapidly move towards a digitised world, listed companies may benefit from the use of certain technology platforms, such as online board portals or digital boardrooms. Jay Shaw, Chief Executive Officer of Praxonomy, explains that the adoption of an online secure board portal prior to listing, as well as by newly listed companies, is an easy step forward in terms of value creation, trust and the mitigation of business risk at board level.

Using a digital board portal can help integrate ESG concerns and perspectives into an organisation's corporate strategy and leadership behaviour, which can in turn usher in paradigm shifts that improve board culture and leadership. The mere fact that board portals provide paperless solutions can itself be underplayed. Environmental sustainability no longer remains at the periphery of organisational priorities, and investor behaviour can be influenced by a company's environmental (and societal) practices.

Apart from streamlining workflows, board portals highlight, support and in effect advocate efficiency, collaborative thought leadership, accountability and compliance, all of which are integral to good corporate governance.

Green finance

A central aspect of corporate governance and ESG is the concept of sustainable business. To meet stakeholders' and investors' expectations on sustainability, the board of a listed company must consider ESG factors in its management and investment strategies.

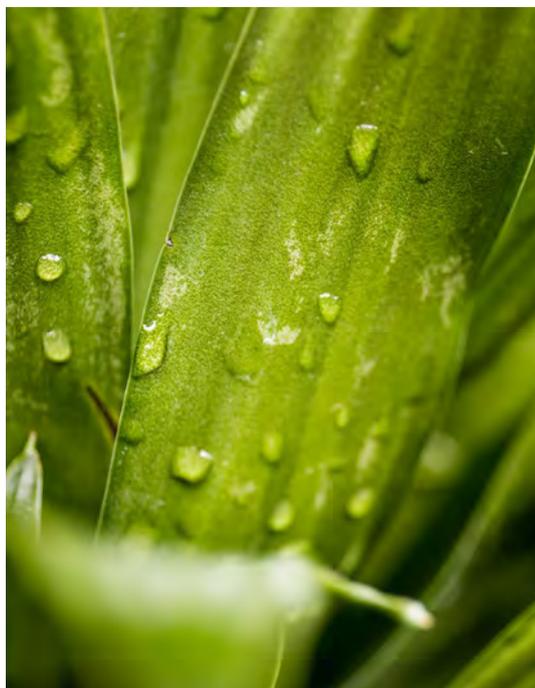
HKEX recently launched its [Sustainable and Green Exchange](#) (STAGE). A key objective of STAGE is to promote the visibility, accessibility and transparency of sustainable and green finance investment products. STAGE will also serve as a hub for information on sustainable and green finance investments.

One such green finance investment product is the green bond. In Hong Kong, the Hong Kong Quality Assurance Agency (HKQAA) provides green certification for bonds and other financial investment products (Green Finance Certifications).

These Green Finance Certifications use an external green assessment standard to certify that the financing of investments by the relevant green finance issuers provide environmental benefits in the broader context of environmentally sustainable development.

Jorine Tam, Director, Corporate Business of HKQAA, believes that from a listed company perspective and in the context of corporate governance and ESG, the HKQAA can play an important role in assisting and adding value to the board in a variety of different ways, including through Green Finance Certifications.

The HKEX will continue to play a vital role in promoting the sustainable development of capital markets and society as a whole. As an information and knowledge sharing hub, STAGE not only provides investors access to information on sustainable and green finance investment products, but also provides a platform for investors to access these green finance investment products.



Key takeaways

- A range of professionals can contribute to a listed company from a corporate governance and ESG perspective. Deriving value from them requires a high level of engagement from the board of the listed company.
- All listed companies must appoint and maintain a company secretary to support the board in its disclosure obligations and announcements.
- Other professionals, such as internal control consultants, solicitors, ESG consultants and compliance advisers can also help companies comply with regulations and add additional value.
- In Hong Kong, the Hong Kong Quality Assurance Agency provides green certification for bonds and other financial investment products, confirming the investment products meets certain standards.

Acknowledgements

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Arnold Ip
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Communication with Shareholders

HKEX's CG Code covers five principle areas of corporate governance, one of which is communication with shareholders. The board of the listed company is responsible for maintaining on-going dialogue between the listed company and its shareholders through establishing and maintaining effective communication channels with shareholders. As shareholder activism, corporate governance and ESG matters became increasingly important to shareholders, effective shareholder communication also rises in importance.

Successful communication with shareholders will build trust, but, as with any relationship, this trust is achieved over time. Given the importance of consistent communication, many listed companies have a dedicated investor relations team. The investor relations team needs to manage two-way communications between the investment community and the company, especially the board.

Channels of disclosure



Communication between the listed company, its shareholders and potential investors is an important part of how the investment community understands and evaluates listed companies. With the fast-moving nature of public markets, accurate and timely disclosures and communication build trust and enhance the reputation of the listed company.

There are a number of different communication channels that listed companies can use to disseminate information and to communicate with shareholders and investors. These channels include, but are not limited to:

The listed company's
web page

Disclosures through
the HKEX website

Newsletters and circulars

Social media

Social media, such as Facebook, WeChat, Instagram, and LinkedIn, have become common channels of communication for listed companies to reach investors, largely because social media is convenient, effective and can reach a large and diversified audience. However, to avoid selective disclosure, listed companies need to ensure the information disclosed through social media and other channels is consistent. Social media can be used as a supplementary means of disseminating information but should not replace the legal and traditional channels of communication, such as the listed company’s website or company announcements. Moreover, listed companies should make sure their social media channels are monitored and that the listed company responds to enquiries raised through these platforms in a timely fashion, while being mindful of their obligations and duties under any applicable laws or regulations.

In the experience of NWS Holdings Limited, a listed company on the Stock Exchange of Hong

Kong, shareholders are most concerned about the company’s business outlook, profitability, balance sheet strength, asset acquisition and disposal strategy and pipeline, as well as its dividend policy and dividend growth outlook. Investors nowadays have increasing concerns about ESG and sustainability, hence in addition to traditional financial metrics and strategic direction, companies should disclose more about their ESG strategy and related matters.

Institutional investors typically have a longer investment horizon than retail investors. As such, institutional investors are more concerned about the long-term business development, sustainability and profitability of a listed company. On the other hand, retail investors are usually more concerned about the short-term stock price, stock trends, current affairs and geopolitics. Having said that, both institutional and retail investors are equally interested in a listed company’s dividend policy, growth outlook and risk management policies.

What should the board be aware of?

The board of a listed company is responsible for meeting the demands of the investment community. It needs to take responsibility for the development and implementation of the listed company’s communication strategy and policies. Effective communication strategies will assist the board with understanding the composition of the shareholder base and how to effectively engage with the shareholders. When formulating its communication strategies, the board should consider:

<p>Price-sensitive information</p>	<p>The board and the investor relations team need to be well-versed in the legal perimeters regarding disclosure of information to ensure no breach of any laws or Listing Rules. The board also needs to balance shareholder communication obligations and its legal obligations, such as not disclosing price-sensitive information.</p>
<p>Meeting log</p>	<p>Maintaining records of shareholder communications and events will enable the board of a listed company to review and develop its communication policies and strategies. It will also assist the board in developing an understanding of the composition of its shareholder base.</p>
<p>Consistent message</p>	<p>Institutional investors in particular will ask questions about business strategy and long-term plans. The board’s communication in this area needs to be consistent, transparent and clear to build confidence in the listed company and its future plans.</p>
<p>Contents</p>	<p>The board must be prepared to discuss not only the listed company’s operating results but also the environment within which it operates. This may include discussions about the market, competitors and how the listed company fared in certain markets compared with its competitors.</p>

Sustained two-way dialogue with shareholders is important. While many fund managers are quite direct in their views of companies, some feel their views are not heard by the board. Regularly discussing the investor relations team's reports in board meetings will help strengthen this dialogue, making the listed company more attractive, especially to institutional investors.

Types of disclosure

Listed companies must maintain fair and equal disclosures to all investors, whether institutional or retail. Corporate announcements and press releases must be disclosed on the same platforms, such as the HKEX website and the listed company's own corporate website, and social media (where applicable), giving all investors access to the information at the same time. It is recommended that the investor relations team's contact details, including both email addresses and phone numbers, are given on the listed company's website for easy communication by shareholders.

Disclosure falls into one of two categories:

Regular cycles	Such as results announcements and regular general meetings
Event-driven communications	Range from fund raising activities and significant transactions, to unexpected/crisis events

The ability of a listed company to manage disclosure events is considered to be a reflection of its corporate governance standards and culture.

The Listing Rules set out a number of continuing communication obligations that listed companies are expected to observe. These include the obligation to make arrangements for annual general meetings and the timely disclosure of financial information. Main board listed companies must publish their annual reports no later than four months, and their half-yearly reports no later than three months, after the date upon which the financial period ended.

With good planning and preparation, regular disclosures are manageable and can be done in a timely manner. Unlike regular disclosures, event-driven disclosures cannot generally be planned for and may not be predictable.

As such, disclosures of this nature are stressful, and time is of the essence. In these circumstances, establishing a small group of key personnel to coordinate the disclosure is of the utmost importance to ensure that the disclosure is accurate and timely. These disclosures are an extremely important aspect of shareholder communication, especially when they are being made in response to a crisis or unplanned event that affects the listed company where shareholders will be looking to the board for reassurance.

Director attendance

An annual general meeting (AGM) provides shareholders with an opportunity to interact with the board of directors of a listed company and, as such, the board are encouraged to attend. Shareholders are also able to raise questions and contribute ideas at the AGM.

Public relations consultants

Listed companies may wish to seek the advice of external parties in managing shareholder communication strategies and policies. A good public relations consultant can complement and assist the listed company's investor relations team through advising the board of a listed company on how investors are likely to perceive the decisions and actions they take, as well as recommending how those actions and decisions should be presented.

Proactive public relations, if used effectively, can shape and distribute positive messages about a listed company that can enhance its ESG profile and increase investor confidence. Public relations consultants know the worlds of traditional media and social media, understanding how they work and how to approach the challenges they raise. In times of crisis, they can help shape and position announcements made by the board, and give advice on the most productive way to inform investors.

These issues are of particular importance when it comes to dealing with the international media, which is read by international investors, as well as shaping the perception of a listed company's commitment to corporate governance and ESG.

Rating agencies and proxy companies may also work directly with a listed company, or may formulate their reports independently. In either case, since many are well-established in the market and their reports are widely used, listed companies should keep track of these companies and, where possible, build relationships with them.



Culture of communication

Investors are becoming increasingly sophisticated and have higher demands and expectations of listed companies in respect of corporate governance and ESG. Actively engaging with investors to understand what their expectations and demands are is a good driver of corporate governance and ESG.

Alongside business and financial performance, institutional investors and fund managers in particular are becoming increasingly concerned about the performance of the boards of listed companies and how minority shareholders' interests are safeguarded. For example, these investors are interested in the role, function and performance of INEDs, the decision-making process of the board, how risks are evaluated and managed for major investments, and the checks-and-balances for connected transactions. As a result, listening to and engaging with shareholders and other relevant stakeholders can strengthen a listed company's corporate governance and ESG.

For the many green fund managers, a listed company's performance is measured not only in terms of the growth of financial capital, but also human and social capital as well. Again, in this area the value of engagement and communication cannot be stressed enough and will greatly assist a listed company in its attempts to meet investors' expectations and create a good corporate governance and ESG culture.

Positive shareholder communication and engagement enables a listed company to build the trust and confidence of the investment community, which will in return contribute to sustained share prices and lower capital costs.

Key takeaways

- Communication between the listed company, its shareholders and potential investors is an important part of how the investment community understands and evaluates listed companies.
- Listed companies can communicate with shareholders through a number of channels, including their webpage, annual reports, disclosures made through HKEX, newsletters and social media.
- To avoid selective disclosure, listed companies need to ensure the information disclosed through different channels is consistent.
- The board of a listed company needs to take responsibility for the development and implementation of the listed company's communication strategy and policies. It must be careful to stay within the legal perimeters of what it can disclose, particularly in relation to price sensitive information.
- Listed companies may wish to employ public relations consultants to assist them with shareholder communications.

Acknowledgements

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Reporting on Corporate Governance and ESG

Board responsibilities

The board of a listed company is required to take full responsibility for corporate governance and ESG issues as set out in the Listing Rules.⁷ There have been a number of regulatory developments in relation to corporate governance and ESG disclosures for listed companies, including:

- Disclosure requirements of the listed company’s nomination policy and board diversity policy became effective in 2019.
- Since July 2020, the ESG Reporting Guide comprises of mandatory disclosures and disclosures on a “comply or explain” basis.

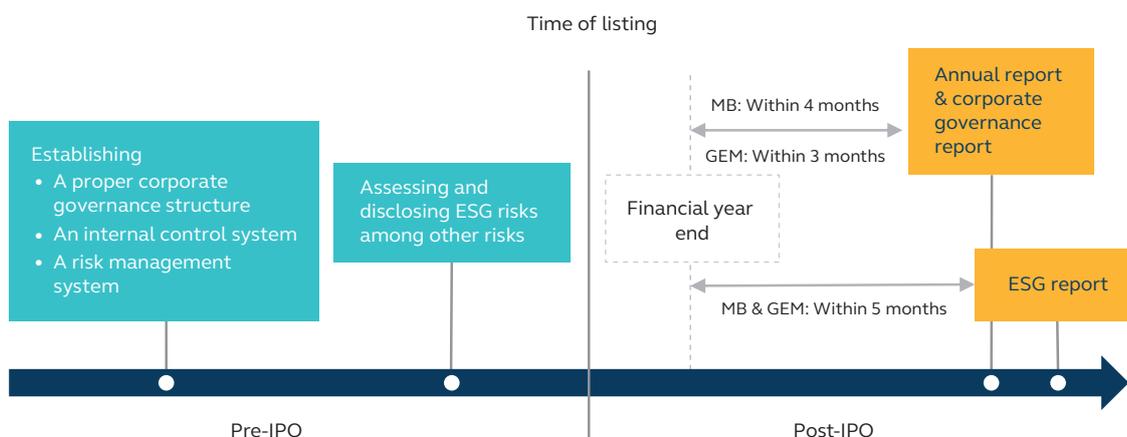
In summary, the board’s responsibilities for corporate governance and ESG disclosures are as follows:

- The board may delegate its corporate governance and/or ESG related matters to management. However, the board must maintain oversight,

guide the management team to whom such responsibilities have been delegated and review key corporate governance and ESG issues which relate to the listed company. This will include shareholder and stakeholder communications.

- The board must keep up to date with regulatory developments and investor expectations on corporate governance and ESG issues, requesting briefings from management when needed.
- HKEX regularly conducts reviews and monitors listed companies’ corporate governance and ESG disclosures. It will make enquiries with listed companies if there are any compliance questions, and may take follow up actions depending on the seriousness of the non-compliance. It is a Listing Rule requirement to report on the “comply or explain” provisions, and non-compliance without giving considered reasons amounts to a breach of the Listing Rule.

Corporate governance and ESG in pre-and post-IPO stages



⁷ Appendices 14 and 27 to the Main Board Listing Rules / Appendices 15 and 20 to the GEM Listing Rules.

Discharging directors' duties

This section looks at examples of matters the board would discuss amongst itself and with management when discharging its responsibilities in terms of corporate governance and ESG disclosures.

1. Strategic integration

Questions for the board about first time disclosures:

- Have we sufficiently demonstrated how we integrate corporate governance and ESG practices in our business plan as set out in the prospectus?
- Is our approach to managing corporate governance and ESG issues enabling them to become a competitive advantage for the company?

Practical examples

• *Original equipment manufacturers (OEM) are often expected by customers to adopt sound sustainable practices and to be assessed by frameworks such as the Higg Index or Ecovadis.*

• *Real estate developers are incentivised by Gross Floor Areas (GFA) concessions to adopt strong building practices, such as BEAM Plus.*

- Does the board statement cover the key components we should be communicating to our stakeholders? Have we integrated corporate governance and ESG issues into our key messaging?

Subsequent disclosures:

- Are we meeting the expectations of our key stakeholders in our corporate governance and ESG disclosures? How are we doing compared to our peers? How can we improve on future corporate governance and ESG disclosures?
- Were there any significant reporting issues, e.g. a change in information coverage, different year-on-year analysis, inconsistent messaging between company disclosures?
- Were there any occurrences of non-compliance or negative news, e.g. privacy breaches, environmental pollution incidents? What is our plan of action to ensure a transparent and balanced disclosure? For example, disclosure of the impact of the incident and the remediation measures adopted is more advisable rather than omission, denial or cover up.

2. Establishing governance structure

Questions for the board about first time disclosures:

- Have we explained the rationale, the consideration of competencies and diversity, and the nomination procedures undertaken in appointing our board?

Subsequent disclosures:

- Are the time commitments devoted by board members reviewed to ensure they can fulfil their roles and responsibilities effectively?
- Do we need to bring in additional expertise to the board, board committees, or executive-level working groups to help with the dynamic business environment and the company's business plan?

Practical examples

- *An Audit Committee can help oversee an effective independent whistle-blowing mechanism that is in place and follow up on serious unresolved internal audit matters.*
- *A Sustainability Committee can help oversee key issues such as labour practices, health and safety practices, climate risks and other corporate governance and/or ESG strategies, e.g. a decarbonisation strategy.*

Subsequent disclosures:

- *As a board, do we understand the latest ESG trends and climate-related issues that are impacting our business? Is additional training required?*
- *Has management analysed the opportunities presented by the ESG and climate-related trends and refreshed the short, medium and longer term business plan?*

3. Risks and opportunities

Questions for the board about first time disclosures:

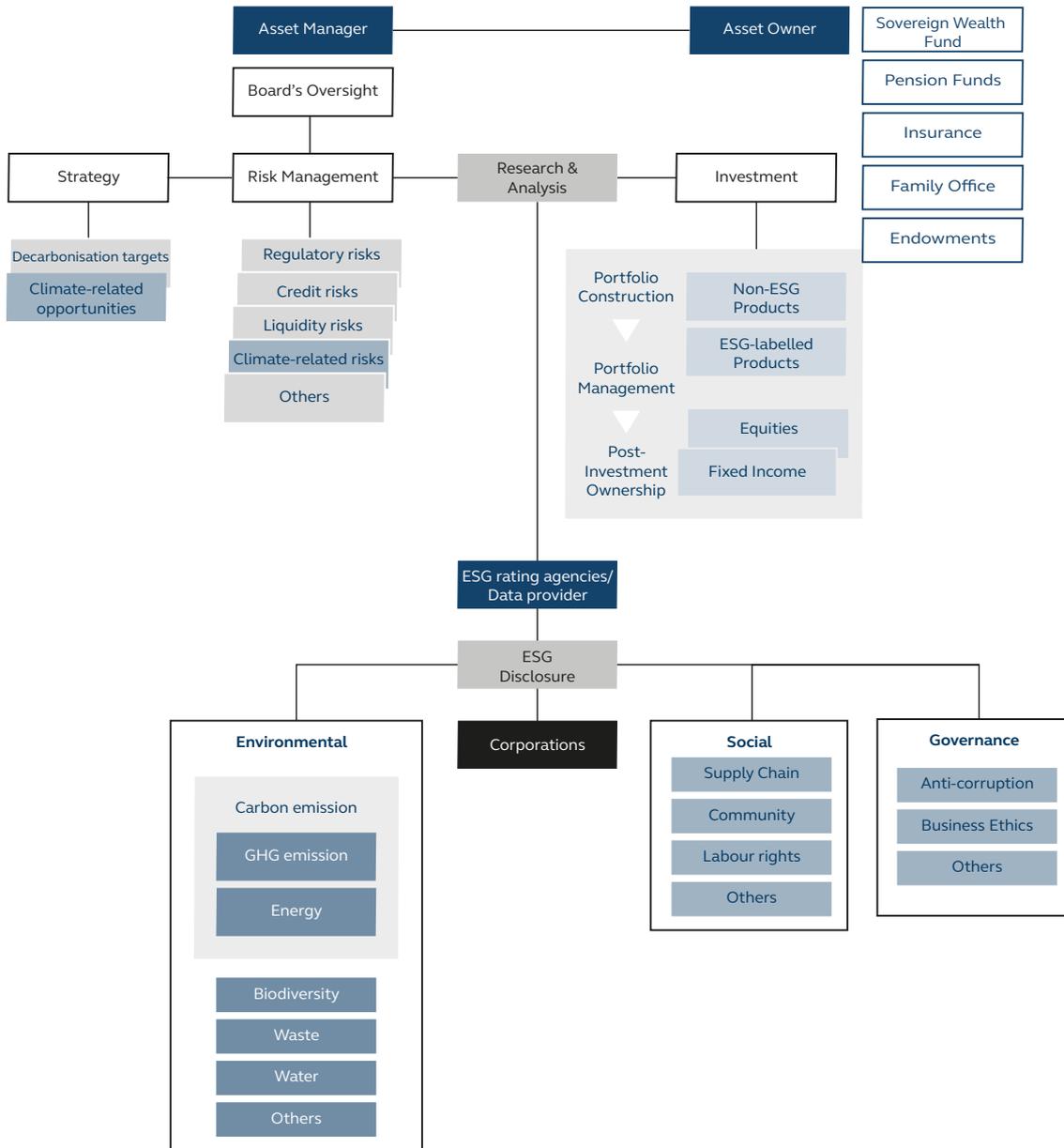
- *Have we addressed the material corporate governance and ESG issues that were included in the prospectus? Are climate-related risks considered as part of our risk management?*
- *Have we demonstrated:*
 - *how the key risks were identified, with appropriate steps taken to implement mitigation measures?*
 - *how the board, board committees, or executive-level working groups participate in the process?*

Practical examples

- *Data privacy has become a key concern for consumer businesses, telecommunication service providers, financial services and other industries. As such, many industries affected by data privacy have included customer data privacy protection as a key ESG issue.*
- *Cyber security is also a key ESG issue for business models that are reliant on digital platforms and information technology, which are exposed to significant cybersecurity risks.*
- *Occupational health and safety measures are needed to protect employees and contractors in electric utilities, public transportation and construction industries.*



Illustrating the ESG ecosystem



Source: PricewaterhouseCoopers Limited

Case Studies

Case Study 1

Customer demand as the driving force for corporate governance and ESG

Prioritising corporate governance and ESG throughout

Crystal International Group Limited

Listed in 2017, Crystal International Group Limited (the Group) is a garment manufacturer which supplies leading apparel brands globally.

More than a compliance exercise

From the beginning, the founder of the Group understood that a commitment to good corporate governance starts at the very top, and that its benefits may only be realised over time. This belief led to the establishment and implementation of a good corporate governance framework at an early stage of the Group's development. The Group actively adopts corporate governance and ESG practices to meet customer demands in order to continue earning their trust and confidence.

Implementing a corporate governance framework

The first significant step in pursuing good corporate governance was to share power and diversify the board, with the Group inviting independent directors to its board as early as 1995 in recognition of the value of having independent views and different perspectives in the decision-making process. Under the board's leadership, the Group implements robust risk management processes, with the identified risks put under the direct oversight of an Executive Committee chaired by the CEO. This 'risk oversight' framework is complemented by a detailed risk assessment process and internal control systems, the effectiveness of which is monitored by the internal audit function, under the oversight of the Audit Committee.

To ensure buy-in from the employees, a comprehensive corporate governance manual covering all operational and control areas has been developed to give guidance to employees. External stakeholders' views are also collected on an ongoing basis using multiple communication channels.

There is a consensus between the board and management that results from the Group's ESG work would not be seen immediately. The board and management recognise that investments made in corporate governance and ESG are worthwhile in building a sustainable and profitable business.

Protecting the environment

As a garment manufacturer, protecting the environment is a key priority of the Group. Customers are increasingly requesting their manufacturers meet certain social and environmental standards. Its ESG framework encompasses environmental protection, product integrity, innovation, employee care and community engagement. The Group has set "5-year Sustainability Targets" since 2007. It adopts low carbon manufacturing processes, uses renewable energy where possible, and utilises energy recovery techniques and energy efficient machinery. Additionally, 80% of the water used is recycled and no hazardous chemicals are discharged. The manufacturing process is highly automated for operational and resources efficiency, as well as to promote workplace safety. To protect customers, products are subject to vigorous testing to ensure product quality and safety.

These corporate governance and ESG efforts have led to the Group receiving significant recognition from customers, business partners and society, as well as achieving a sound business with stable profits and low debt, translating into long term business success. The Group has continued to build on its relationship with existing customers, as well as gaining new business from a number of leading international sports brands despite the challenging environment created by COVID-19.

ESG achievements

The Group has achieved verified Higg Facility Environmental Module (Higg FEM) outstanding scores for all of its denim factories. It has also won both the Corporate Governance Excellence Award and the Sustainability Excellence Award in the 2019 Hong Kong Corporate Governance Excellence Awards organised by the Chamber of Hong Kong Listed Companies.

Case Study 2

ESG voice from an asset owner

Integrating ESG into investment

AIA Group

AIA Group's (the Group) purpose of helping its customers and communities lead healthier, longer, better lives is at the core of its ESG strategy.

As an insurer, the Group performs a multifaceted role and considers ESG through different perspectives: as an asset owner and as a listed company. The Group understands the importance of ESG integration within its investment portfolio. In 2019, the Group became a signatory to the Principles for Responsible Investment (PRI), and has been a supporter of the Task Force for Climate-related Financial Disclosures (TCFD) since 2018.

ESG investment structure

ESG issues are structurally incorporated into its investment governance framework and are underpinned across the Group by a mandatory ESG Standard. AIA implements a top-down approach in terms of internal ESG communications and commitment, with messages cascading down through the Group Investment department from the Group Chief Investment Officer, who is a member of the Group Executive Committee. Capacity building and enhancements relating to ESG are provided to portfolio managers and research analysts at their business units. The Group's research analysts incorporate an analysis of ESG issues relating to their covered companies and sectors on a mandatory basis. They also monitor ESG risks and developments, and update their portfolio managers based on a variety of sources, including ESG reports, research reports, news media, and other publicly-available information.

ESG investment strategy

To deliver on its ESG Strategy, the Group has excluded tobacco manufacturing and cluster munitions from its investment portfolio, as well as structuring and implementing automated pre-trade controls in its trading systems to ensure

compliance with these exclusions, which are articulated in the ESG Standard. The Group also continues to develop approaches consistent with global best practice to address and manage down its exposure to carbon intensive sectors, such as coal mining and coal-fired power, to address the risk of stranded assets and in developing the climate resilience of its portfolio.

AIA Group's investment managers

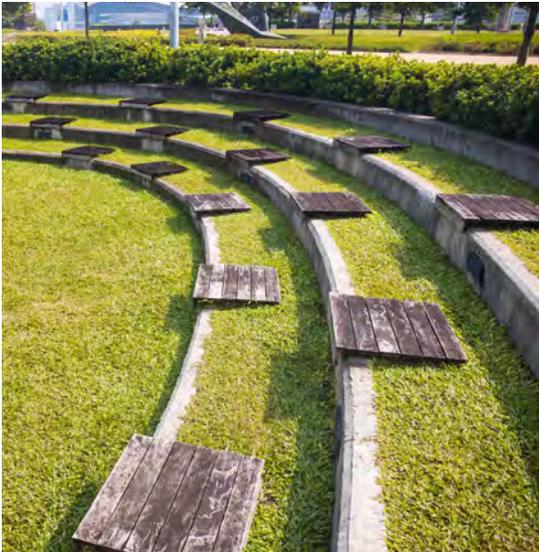
As an asset owner, the Group works with many external investment managers who manage and invest money on its behalf. As such, pursuant to the ESG Standard, it considers the ESG practices of investment managers during selection, reviewing their approach to both ESG engagement with investee companies and assessing ESG factors during investment decisions. The Group continues to monitor the ESG practices of these external managers, including during periodic relationship reviews. The Group's mandated investment managers are also contractually required to abide by its investment exclusion list.

Company engagement as part of the investment assessment process

The Group also engages with businesses on ESG topics before an investment decision is made, and afterwards on matters of thematic interest to the Group, or if any material concerns arise. For example, in 2019, the Group engaged with more than 1,400 companies in its investment portfolio, assessing how these businesses addressed climate change risks and what steps they were taking to monitor, disclose and reduce their environmental footprint. The Group continues to engage with material sectors and companies in its investment portfolio on their plans to transition and future-proof their businesses. The consideration of ESG issues, whether environmental, social or governance, is mandated when portfolio managers are determining how to exercise a vote in relation to securities in their investment portfolio.

Key takeaways

- The board of a listed company is required to take responsibility for corporate governance and ESG issues as set out in the Listing Rules.
- The board may delegate its corporate governance and/or ESG related matters to management, but must maintain oversight, guide the management team, and review key corporate governance and ESG issues on a timely basis.
- HKEX regularly conducts reviews and monitors listed companies' corporate governance and ESG disclosures.



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Resources

HKEX

[Listing Rules](#) (including the Corporate Governance Code)

Corporate governance

1. [Director Training Webcast](#)

Topic 1: Duties of directors and role and function of board committees

- [Board committees and board diversity](#)
- [Delegation](#)
- [Conflicts of interest](#)
- [Complex transactions](#)
- [Information/resources and training](#)

Topic 2: Risk management and internal controls

- [Identifying and assessing risks](#)
- [Control systems](#)
- [Annual and ongoing reviews](#)
- [The audit committee and internal audit function](#)

Topic 3: Corporate governance directors' and company secretary's roles

- [Corporate governance – who is responsible?](#)
- [Support for the board](#)
- [Selecting the right company secretary](#)
- [Managing inside information](#)
- [Board secretaries](#)
- [Using an external service provider as company secretary](#)

Topic 4: Directors' responsibilities at IPOs

- [Change of mindset for business owners](#)
- [Role of directors](#)
- [Appointment of INEDs](#)
- [Internal controls](#)

2. [INEDs' role in corporate governance](#)

(e-training)

3. [Guidance for boards and directors](#)

4. [Disclosure reviews on CG Code](#)

5. CG-related guidance on disclosure in the prospectus

- Section H of [HKEX guidance letter GL86-16](#) (relating to directors)
- Paragraph 3.5 and 3.6 in section H of [HKEX guidance letter GL86-16](#) (relating to diversity)
- Paragraph 3.2 in section E of [HKEX guidance letter GL86-16](#) (relating to risk management)

6. [Frequently Asked Questions relating to the CG Code](#)

ESG

1. [A Guide for the Board and Directors: Leadership roles and accountability in ESG](#)

2. [ESG governance and reporting](#) (e-training)

3. [Exchange's new ESG requirements](#) (e-training)

4. Other guidance material relating to ESG governance:

“[Managing ESG risks – an investor's perspective](#)” in [Director Training Webcast](#)

5. Other guidance materials relating to ESG reporting:
 - a. [Frequently Asked Questions relating to ESG reporting](#)
 - b. [A Step-by-Step Guide to ESG reporting](#)
 Appendices of the Step-by-Step Guide:
 - [Appendix 1: Toolkit](#)
 - [Appendix 2: Reporting guidance on Environmental KPIs](#)
 - [Appendix 3: Reporting guidance on Social KPIs](#)
 - [Appendix 4: Table of references to international standards/guidelines and other resources](#)
 - c. “[Comply or explain – how to do it properly?](#)” in [Director Training Webcast](#)
 - d. [Disclosure reviews on ESG reporting](#)
6. ESG-related guidance on disclosure in the prospectus
 - a. Key areas 43 Environmental and Social matters and 43 Risk management and internal control systems under paragraph 4.1 in section E of [HKEX guidance letter GL86-16](#) (relating to ESG matters and risks)
7. [ESG Resources Hyperlinks](#)

Other resources

Securities and Futures Commission’s [Codes on Takeovers and Mergers and Share Buy-backs](#), Hong Kong, 2018.

Hong Kong Institute of Directors :
[Guidelines for Directors](#) 4th edition, Hong Kong, 2014.

[Guide for Independent Non-Executive Directors](#) 5th edition, Hong Kong, 2012.

Guide for Remunerating Independent Non-Executive Directors 4th edition, Hong Kong, 2020. (Print edition only)

Report on the HKIoD Corporate Governance Scorecard 2020 6th edition, Hong Kong, 2020. (Print edition only)

Independent Non-Executive Director: Role and Fulfilment (training course), Hong Kong, 2020. (Print edition only)

OECD’s [G20/OECD Principles of Corporate Governance](#), OECD Publishing, Paris, 2015.

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