ANALYSIS OF CORPORATE GOVERNANCE PRACTICES DISCLOSURE IN 2009 ANNUAL REPORTS

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Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司

I. EXECUTIVE SUMMARY

1. The Stock Exchange of Hong Kong Limited (the "**Exchange**") has completed its 2009 review of listed issuers' compliance with the Code on Corporate Governance Practices ("**Code**").

2. The 2009 review analysed corporate governance disclosures made by 132 issuers in their 2009 annual reports. We chose this sample by dividing 1,319 issuers, listed as at the end of 2009, into "Large Cap", "Mid Cap" or "Small Cap" categories according to their market capitalisation. We then took 10% of the issuers from each category.

3. In the 2006 and 2007 Code reviews, we sent all issuers a questionnaire to ascertain their compliance with the Code. The scope of the 2009 review was limited to a review of the annual reports of the 132 issuers.

4. The 2009 review analysed the annual accounts sample for compliance with:

   (a) Code Provisions ("**CPs**"). Issuers are required to disclose if they complied with CPs in their annual report. If issuers do not comply they are required to disclose why;

   (b) Recommended Best Practices ("**RBPs**"). Issuers are not required to disclose whether they comply with RBPs;

   (c) internal control CPs and RBPs; and

   (d) other corporate governance practices including establishing a nomination committee, remuneration committee, corporate governance committee and the performance of a board evaluation.

5. The 2009 review found 39% of issuers complied with all CPs. This is the same as in the last review in 2007. 99% of issuers complied with 41 or more CPs. This figure was 98% in 2007. A higher percentage (52%) of Large Cap issuers fully complied with all CPs than the percentage (44%) in the 2007 review. However, a smaller percentage of Medium Cap and Small Cap issuers fully complied with all CPs compared with the 2007 review.

6. The 132 issuers reviewed fully disclosed compliance with only ten of the 32 RBPs.

7. All issuers conduct an internal control review. However, a much lower percentage (28.8%) of issuers stated that they did so annually compared with the percentage for the 2007 review (67.4%) and 2006 review (68.6%). 41.7% of issuers had an internal audit function compared to 43.4% in the 2007 review.

8. 37% of issuers in the 2009 review had established a nomination committee. 98% of them had established a remuneration committee. Both these committees are composed mostly of INEDs with an average of about four members. Only 6 issuers (5%) had established a corporate governance committee. Only one issuer (Standard Chartered Bank) had conducted a board evaluation in 2009.

II. BACKGROUND

(A) SCOPE OF PREVIOUS REVIEWS

9. The Exchange reviewed issuers' Code compliance for 2005, 2006 and 2007.

10. The scope of previous reviews included one or both of the following:

    (a) A review of issuer's annual reports and analysis of CP compliance;

    (b) A questionnaire to issuers on their CP and RBP compliance.

Account Year	Number of Annual Reports Reviewed for CP compliance	Issuer questionnaire used?	Number of questionnaire replies on CPs	Number of questionnaire replies on RBPs
2005	621	No	N/A	N/A
2006	*See paragraph 12*	Yes	1114	558
2007	*See paragraph 12*	Yes	1213	584

Table 1: Scope of Previous Reviews

11. For the 2006 and 2007 reviews, Code compliance was reviewed for all issuers (both GEM and Main Board) except for long suspended and recently de-listed companies and one secondary listed company Manulife Financial Corporation (stock code 945).

12. For the 2006 and 2007 reviews, CP compliance was measured based on issuers' replies to the questionnaire. These replies were verified with issuers' disclosure in their annual reports for a 20% sample.

(B) AMENDMENTS TO THE CODE SINCE THE LAST REVIEW

13. The following amendments have been made to the Code since the 2007 Code review:

    Added

    (a) CP C.2.2 – the board's annual review should, in particular, consider the adequacy of resources, qualifications and experience of staff of the issuer's accounting and financial reporting function, and their training programmes and budget.

    (b) CP E.1.3 – an issuer should arrange for the notice to shareholders to be sent in the case of annual general meetings at least 20 clear business days before the meeting and to be sent at least 10 clear business days in the case of all other general meetings.

Removed

(c) CPs E.2.2 and E.2.3 on voting by poll were removed. Voting by poll was made mandatory.

III. SCOPE OF 2009 REVIEW

SAMPLING METHOD

14. 1,319 issuers were listed as at 31 December 2009. We categorised these issuers as shown in Table 2.

Category	**Number of Issuers**
“Large Cap” (>1,000 million market capitalisation)	689
“Mid Cap” (>400 million and <=1,000 market capitalisation)	286
“Small Cap” (<=400 market capitalisation)	344

Table 2: Categorisation of Issuers by Market Capitalisation

15. The Exchange randomly selected 10% of the issuers from each category resulting in a sample of 132 issuers. A 10% sample was chosen as it is large enough to be representative of the whole issuer population.

IV. KEY FINDINGS – CODE PROVISIONS

OVERALL COMPLIANCE

16. The percentage of overall CP compliance (39%) shows no improvement compared with the 2007 review.

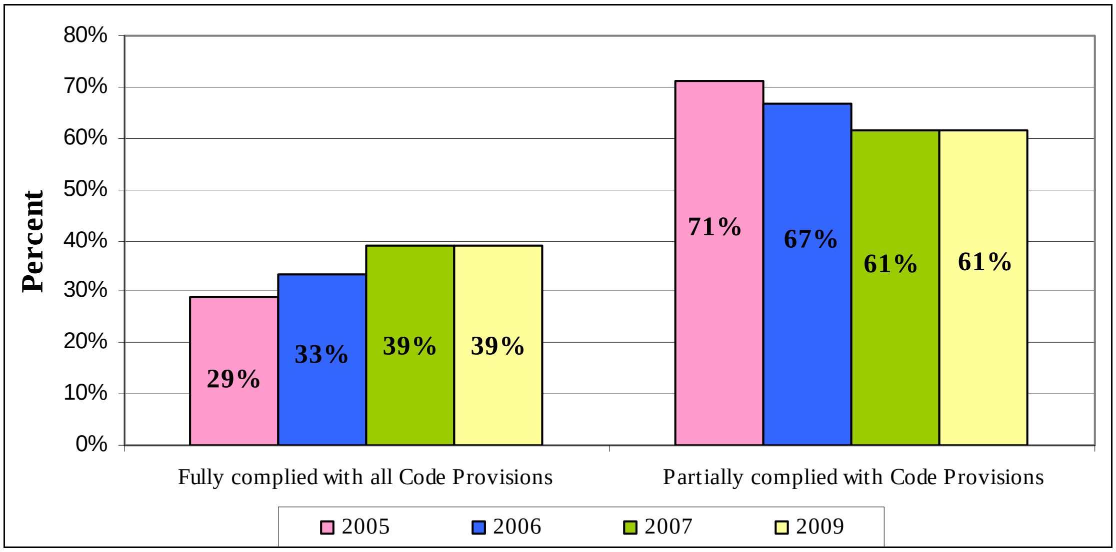

Chart 1: Overall CP Compliance Results for all Four Reviews

17. If GEM companies are excluded from review results, there is a 2% improvement in overall CP compliance for Main Board issuers compared to previous reviews.

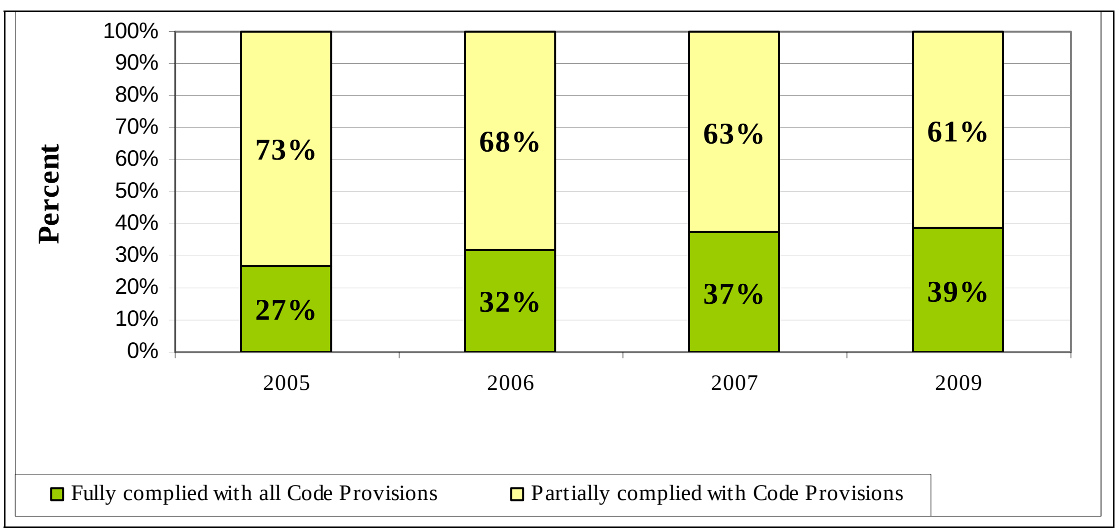

Chart 2: Overall CP Compliance Results for Main Board Issuers Only

18. 99% of issuers (131 out of 132) stated they had fully complied with 41 or more of the 45 code provisions. In the 2007 review this figure was 98%.

Number of code provisions complied with	Number of Issuers
33	0
34	0
35	0
36	0
37	0
38	0
39	0
40	1
41	1
42	11
43	22
44	45
45	52
Total	**132**

Table 3: Distribution of Main Board Issuer Compliance with Code Provisions

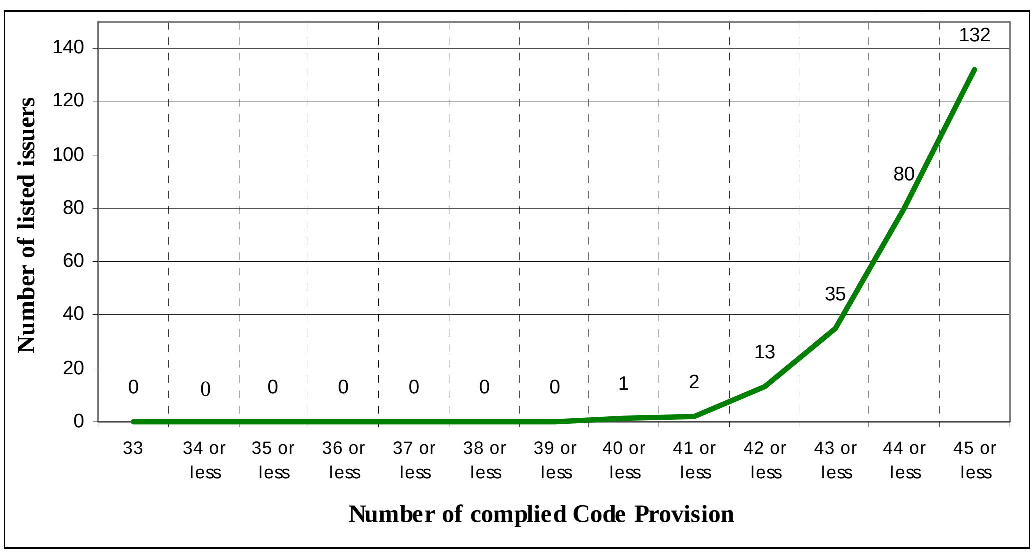

Chart 3: Cumulative Distribution of Main Board Issuer Compliance with Code Provisions

BY MARKET SIZE

19. A higher percentage (52%) of Large Cap issuers fully complied with all CPs than the percentage (44%) in the 2007 review. However, a smaller percentage of Medium Cap and Small Cap issuers fully complied with all CPs compared with the 2007 review.

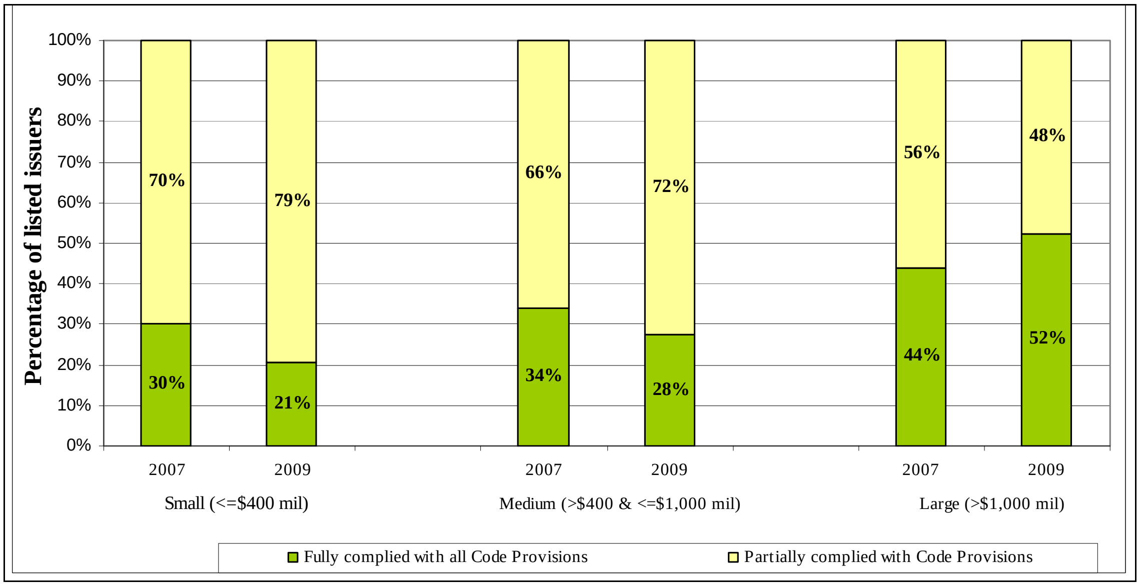

Chart 4: Comparison of CP Compliance by Market Size in 2007 and 2009

TOP FOUR CP DEVIATIONS

20. Chart 5 shows the top ten CPs issuers deviated from in 2009.

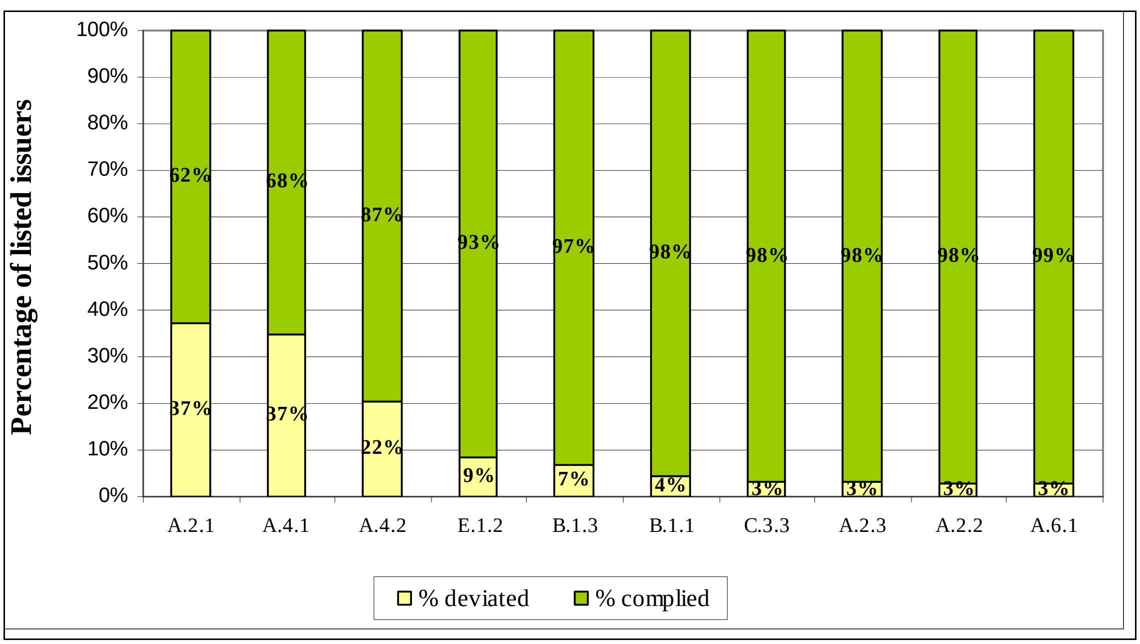

Chart 5: 2009 Top 10 CP Deviations

21. The top four CPs issuers deviated from are the same as in previous reviews.

A.2.1 – The roles of chairman and chief executive office should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and the chief executive officer should be clearly established and set out in writing.

	2009		**2007**		**2006**	
Reasons given by listed issuers for their decision not to follow CP A.2.1	**Number of listed issuers**	**% of listed issuers**	**Number of listed issuers**	**% of listed issuers**	**Number of listed issuers**	**% of listed issuers**
Same person provides the Group with strong and consistent leadership, allows for more effective planning/formulation and execution/implementation of long-term business strategies	16	37.2%	118	33.0%	100	30.9%
Contributions are made by all executive directors/INEDs, who bring different experience and expertise and who meet regularly to discuss issue affecting the issuer's operations	6	14.0%	88	24.6%	58	17.9%
The Board has confidence in the person who acts as CEO and chairman, eg because the person is knowledgeable, well known and/or has a good understanding of the operations of the issuer	5	11.6%	49	13.7%	34	10.5%
Due to the size of the Group, the scope and/or nature of its business and/or a practical necessity arising from the corporate operating structure	7	16.3%	44	12.3%	41	12.7%
The issuer considers that its structure is sufficiently consistent with the Code and the deviation has no materially adverse impact on its corporate governance structure	1	2.3%	2	0.6%	7	2.2%
The responsibilities of the chairman and CEO are clear and distinct and therefore need not be set out in writing	2	4.7%	3	0.8%	3	0.9%
Others	1	2.3%	14	3.9%	3	0.9%
More than one of the above	5	11.6%	40	11.2%	78	24.1%
TOTAL:	**43**	**100%**	**358**	**100%**	**324**	**100%**

Table 4: Reasons for Not Separating Chairman and CEO Roles

A.4.1 –Non-executive directors should be appointed for a specific term, subject to re-election

22. The issuers that did not comply with this CP all stated that non-executive directors are not appointed for a specific term but are subject to retirement by rotation at each AGM.

A.4.2: All directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.

23. Table 5 below divides non-compliance with this CP into its two parts.

Breakdown on the type of non-compliance	Number of non-compliant listed issuers	% of non-compliant listed issuers
Did not subject a director filling a casual vacancy to re-election at first AGM after appointment	2	14.3%
Did not subject every director to retirement by rotation at least once every three years	8	57.1%
Did not comply with both parts of CP	4	28.6%
TOTAL:	**14**	**100%**

Table 5: Breakdown of Non-Compliance with CP A.4.2

24. Issuers that did not comply with the first part of the CP stated that casual vacancies rarely occur or that the time between filling a casual vacancy and the next AGM is too short to require re-election.

25. Issuers that did not comply with the second part of this CP stated either or both of the following:

(a) the Chairman and Managing Director are not subject to retirement by rotation since the issuer believes continuation is a key factor to the successful implementation of any long term business plans;

(b) the issuer's constitutional documents provide for one-third of the directors to retire from office each year.

E.1.2: the chairman of the board should attend the AGM and arrange for the chairman of the audit, remuneration and nomination committees (as appropriate) or in the absence of the chairman of such committees, another member of the committee or failing this his duly appointed delegate, to be available to answer to questions at the AGM. The chairman of the independent board committee (if any) should also be available to answer questions at any general meeting to approve a connected transaction or any other transaction that is subject to independent shareholders' approval.

26. The reason issuers give for not complying with this CP is, most commonly, that the persons named in the CP had another business engagement or other commitment that prevented them from attending the AGM or general meeting to approve a connected transaction.

V. KEY FINDINGS – INTERNAL CONTROL

FREQUENCY OF INTERNAL CONTROL REVIEW

27. CP C.2.1 states that directors should conduct a review of the issuer's internal control effectiveness at least annually. Directors should disclose the result of this review in the issuer's annual report.

28. All the annual reports we reviewed stated that an internal control review was conducted by the issuer. We reviewed how frequently this internal control review was conducted.

29. A much lower percentage of issuers (28.8%) stated that they conducted an internal control review annually compared with the percentage for 2007 (67.4%) and 2006 (68.6%).

30. A much higher percentage (31.1%) stated that they conducted reviews "regularly" or "from time to time" or "on an ongoing basis" compared with 2007 (2.6%) and 2006 (2.4%).

31. One third of issuers (33.3%) did not mention the frequency of the review of internal controls. So, we do not know how frequently these issuers conducted their internal control review.

	2009		2007		2006	
Frequency for conducting internal control review	**Number of listed issuers**	**% of listed issuers**	**Number of listed issuers**	**% of listed issuers**	**Number of listed issuers**	**% of listed issuers**
Annually	38	28.8%	817	67.4%	746	68.6%
Half-yearly (or twice)	3	2.3%	264	21.8%	219	20.1%
Quarterly	6	4.5%	88	7.3%	83	7.6%
Other frequency	41	31.1%	31	2.6%	26	2.4%
No mention at all	44	33.3%	4	0.3%	5	0.5%
No internal control review conducted	0	0.0%	9	0.7%	8	0.7%
Total	**132**	**100%**	**1,213**	**100%**	**1,087**	**100%**

Table 6: Frequency of Internal Control Review

INTERNAL AUDIT FUNCTION

32. RBP C.2.6 states that issuers without an internal audit function should review the need for one on an annual basis and disclose the outcome of the review in its annual report.

33. 41.7% of issuers stated in their annual reports that they had an internal audit function. This compares to 43.4% of issuers that replied to 2007 review's questionnaire stating that they had an internal audit function.

VI. KEY FINDINGS – RECOMMENDED BEST PRACTICES

34. It is not mandatory for issuers to disclose in their annual report whether they comply with RBPs. Of the 132 issuers reviewed, only 3 (2.2%) disclosed full details of their compliance with all 32 RBPs.

CHANGE TO METHOD OF REVIEW

35. For the 2006 and 2007 reviews, issuers answered a questionnaire on whether they complied with each RBP. This questionnaire was not compulsory. Approximately half of issuers responded for each review (see Table 1). For 2009, annual accounts were reviewed to determine RBP compliance.

36. If issuers do not disclose whether or not they comply with RBPs it cannot be assumed that they did not comply. This is because disclosure of RBP compliance is not mandatory. For this reason it is not possible to compare compliance with all RBPs with previous years.

RBPs WITH FULL DISCLOSURE

37. For ten out of the 32 RBPs, all 132 issuers disclosed whether or not they complied.

RBP	Description	% Comply	% Not Comply	% N/A	Reason for N/A
A.3.2	INEDs represent 1/3rd of Board	86%	14%	0%	
A.4.8	Reason for INED's independence in circular proposing re-election	73%	2%	25%	No election of INEDs in year
A.5.6	Number and nature of offices held by each director disclosed	60%	40%	0%	
A.4.4	Nomination committee established with INED majority	36%	64%	0%	
A.3.3	Directors list (with role, function and whether independent) on website	29%	71%	0%	
C.2.4	Disclosure of how issuer has complied with internal control CPs	23%	77%	0%	
C.1.5	Continuous practice of quarterly financial reporting	13%	0%	87%	Have never reported quarterly
C.1.4	Publication of quarterly financial results	11%	89%	0%	
B.1.7	Remuneration payable to senior management disclosed in annual report	5%	95%	0%	
A.4.3	INED of > 9 years service subject to re-election by shareholder approval	2%	17%	81%	No INED served > 9 years

Table 7: Compliance Rate for RBPs with Full Disclosure (Ranked by Compliance Percentage)

38. Table 7 includes a “% N/A” column. This shows the percentage of issuers for which the RBP was not applicable. This may happen in circumstances when compliance with one RBP is dependent on compliance with another.

39. It is difficult to check compliance with RBPs that cannot be empirically measured. For example, RBP A.2.5 states that “The chairman should take responsibility for ensuring that good corporate governance practices and procedures are established.” Most issuers (89%) choose not to mention explicitly whether this chairman’s responsibility has been fulfilled.

VII. KEY FINDINGS - OTHER CORPORATE GOVERNANCE PRACTICES

(A) NOMINATION COMMITTEE AND REMUNERATION COMMITTEE

40. 49 out of the 132 issuers reviewed (37%) have a nomination committee. 130 out of the 132 issuers (98%) have a remuneration committee.

COMPOSITION

41. RBP A.4.4 and CP B.1.1 state, respectively, that a majority of the members of the nomination and remuneration committees should be INEDs. Table 8 shows how issuers complied.

	Nomination Committee	**Remuneration Committee**
Two-thirds or more INEDs	71%	78%
More than a third and less than two thirds INEDs	27%	22%
A third or less INEDs	2%	0%
TOTAL	**100%**	**100%**

Table 8: INED Composition of Nomination and Remuneration Committees

42. Table 9 shows the average number directors in total and by type that comprise nomination and remuneration committees.

	Nomination Committee (average)	**Remuneration Committee (average)**
Number of executive directors	1.0	0.7
Number of non-executive directors	0.2	0.2
Number of INEDs	2.8	2.7
TOTAL	**3.9**	**3.7**

Table 9: Number of Directors on Nomination and Remuneration Committees

TYPE OF COMMITTEE CHAIRMAN

	Nomination Committee	Remuneration Committee
Executive director	23%	22%
Non-executive director	8%	4%
INED	69%	74%
TOTAL	**100%**	**100%**

Table 10: Type of Committee Chairman

WRITTEN TERMS OF REFERENCE

43. RBP A.4.5 and CP B.1.1 state, respectively, that nomination and remuneration committees should have written terms of reference.

	Nomination Committee	Remuneration Committee
Committee has written terms of reference	82%	77%
Committee has no written terms of reference	18%	23%
TOTAL	**100%**	**100%**

Table 11: Disclosure of Written Terms of Reference

44. Table 12 shows how nomination and remuneration committees' written terms of reference are published.

	Nomination Committee	Remuneration Committee
On Website	50%	62%
Given out on request	10%	7%
Mentioned in annual report but not on website	40%	31%
TOTAL	**100%**	**100%**

Table 12: Disclosure of Written Terms of Reference

DISCLOSURE OF NON-EXECUTIVE DIRECTORS' ATTENDANCE

45. RBP A.5.7 states that non-executive directors should regularly attend nomination and remuneration committees. Table 13 shows whether this attendance was disclosed in the issuer's annual report.

	Nomination Committee	**Remuneration Committee**
Disclose non-executive director's attendance	90%	91%
Do not disclose non-executive director's attendance	8%	8%
N/A – No meetings held	2%	1%
TOTAL	**100%**	**100%**

Table 13: Disclosure of Non-Executive Director's Attendance at Committee Meetings

(B) CORPORATE GOVERNANCE COMMITTEE

46. Of the 132 issuers reviewed, 6 issuers (5%) had established a corporate governance committee.

47. The major responsibilities of these committees included:

(a) to develop and ensure the Group's overall corporate governance policies and practices;

(b) to ensure the company and its group's compliance with disclosure obligations pursuant to the Listing Rules; and

(c) to review and advise upon matters in respect of the present or future regulation of the company's businesses.

(C) BOARD EVALUATION

48. Of the 132 issuers reviewed, only one (Standard Chartered Bank) mentioned in their annual report that a board evaluation was conducted during the 2009 financial year. The board evaluation was led by the chairman supported by the group company secretary.