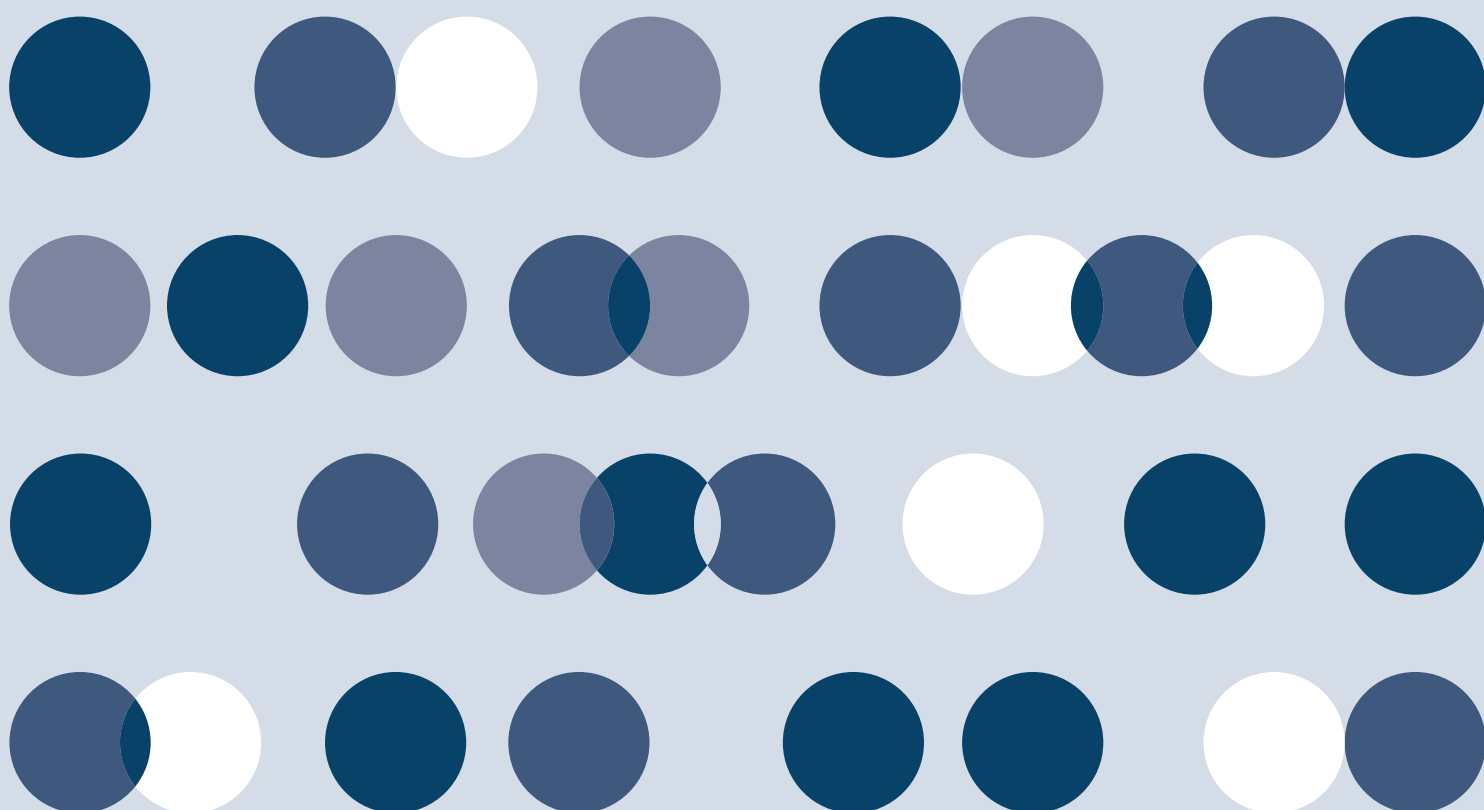


November 2018

ANALYSIS OF CORPORATE GOVERNANCE PRACTICE
DISCLOSURE IN JUNE AND DECEMBER YEAR-END 2017
AND MARCH YEAR-END 2018 ANNUAL REPORTS



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EXECUTIVE SUMMARY

1. The Stock Exchange of Hong Kong Limited (“**Exchange**”) has completed its 2017/2018 review (“**2017/2018 Review**”) of issuers’ compliance with the Corporate Governance Code and Corporate Governance Report (“**Code**”). This is our tenth review since the publication of the inaugural review report in 2007.
2. The 2017/2018 Review involved analysing the disclosures made by 400 randomly selected issuers (“**Sample Issuers**”), of which 300 had a financial year-end date of 31 December 2017, and 100 with financial year-end dates of 30 June 2017 and 31 March 2018.¹
3. As with previous reviews, the results of the 2017/2018 Review demonstrate issuers’ high level of compliance with the Code. Whilst the compliance rates are similar to previous years, we have noted a 2% rise in the number of issuers that complied with all 78 Code Provisions (“**CPs**”), and Chairmen’s attendance at general meetings has improved by 4%.
4. We have set out a summary of the explanations given by the Sample Issuers in respect of the five CPs with the lowest compliance rates and our comments, including the rationale for the CPs and how the explanations might be improved. In the November 2015 review report², we recommended issuers that decided to deviate from the CP requiring separation of the roles of chairman and chief executive to provide explanations on how they have addressed the governance issue of the leadership’s lack of checks and balances. We are pleased to observe a generally more comprehensive explanation being given by Sample Issuers that deviated from this CP and in particular, a majority of them have addressed the issue of balance of powers on the board in their explanations.
5. In addition to examining the Sample Issuers’ compliance with the CPs, the 2017/2018 Review also reviewed their disclosures under the Code’s Mandatory Disclosure Requirements (“**MDRs**”) and Recommended Disclosures (“**RDs**”, compliance obligation is voluntary). We focused on the summary of work of the board committees as we observed a varied level and quality of disclosure in this area. We also examined the disclosures relating to board diversity as we noted from previous reviews that some issuers did not disclose their board diversity policies despite claiming to have such policies whilst others may have provided “boiler-plate” style policies. These areas of disclosures are important and they go some way to demonstrate issuers’ corporate governance efforts. Whilst Sample Issuers’ disclosures under the MDRs are generally of a high standard, we consider there is still room for improvement.
6. Together with the Exchange’s other recent initiatives in this area, the 2017/2018 Review is a part of the Exchange’s continuing effort to maintain high corporate governance standards amongst issuers. By identifying shortfalls in issuers’ corporate governance reporting and providing guidance on ways in which such reporting may be improved, we hope and expect that the 2017/2018 Review would contribute to better future reporting.
7. In July 2018 the Exchange published the “Consultation Conclusions on Review of the Corporate Governance Code and Related Listing Rules” (“**Consultation Conclusions**”)

¹ See paragraphs 14 and 15 for the sampling method of the 2017/2018 Review.

² In November 2015, the Exchange published a review of the corporate governance practice disclosures made by issuers in the 2014 annual reports. The review report is available at:
http://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Other-Resources/Exchanges-Review-of-Issuers-Annual-Disclosure/Review-of-Implementation-of-Code-on-Corporate-Governance-Practices/CG_Practices_2014_e.pdf?la=en

to its latest consultation published in November 2017.³ The review has brought about changes to the Code and related Rules on, amongst others, INEDs' nomination and election. The changes will make the election process of INEDs more transparent so as to enhance the board's accountability to shareholders. There will be requirements for disclosure of potential INEDs' time commitment, perspectives, skills and experience as well as diversity considerations. The Rules on INEDs' independence criteria have been strengthened and it will be mandatory for the issuer to have and disclose their board diversity policy and nomination policy.

8. To equip issuers to prepare for the new corporate governance regime effective 1 January 2019, which resulted from the Exchange's latest consultations in this area, the Exchange will release a Directors' E-Training webcast entitled "INEDs' Role in Corporate Governance" before the end of 2018 ("**E-training**").
9. Providing demonstrations with case scenarios and multiple choice questions and answers, the one-hour E-training aims to equip its audience with an understanding of:
 - (i) the key changes to the Corporate Governance Code and related Listing Rules;
 - (ii) independent non-executive directors' ("**INEDs**") role in corporate governance; and
 - (iii) additional corporate governance measures for issuers with weighted voting rights ("**WVR Issuers**").

Key Findings on Compliance with CPs Compared with 2016 Review

Code Provisions		
	2017/2018 Review	2016 Review ⁴
Compliance with all 78 CPs	36%	34%
Compliance with 75 or more CPs	94%	94%
Compliance with 70 or more CPs	100% ⁵	100% ⁶
Level of full compliance with reference to market capitalisation	Large-cap > Mid-cap > Small-cap ⁷	Large-cap > Mid-cap > Small-cap ⁸

³ In July 2018 the Exchange published the "Consultation Conclusions on Review of the Corporate Governance Code and Related Listing Rules" to its latest consultation published in November 2017. See http://www.hkex.com.hk/News/Market-Consultations/2016-to-Present/November-2017-Review-of-the-CG-Code?sc_lang=en..

⁴ In October 2017, the Exchange published a review of the corporate governance practice disclosures made by issuers with a financial year-end date of 31 December 2016. The review report is available at: http://www.hkexnews.hk/reports/corpgovpract/Documents/CG_Practices_201612_e.pdf

⁵ 99.5% of the Sample Issuers complied with 70 or more CPs.

⁶ In the 2016 Review, 99.6% of issuers complied with 70 or more CPs.

⁷ See paragraph 16 for the composition of Large-cap, Mid-cap and Small-cap issuers.

⁸ The 2016 Review defined "large-cap" as issuers with a market capitalisation of greater than HK\$4.2 billion, "mid-cap" as issuers with a market capitalisation greater than HK\$0.7 billion and smaller than or equal to HK\$4.2 billion, and "small-cap" as issuers with a market capitalisation of smaller than or equal to HK\$0.7 billion.

Code Provisions		
	2017/2018 Review	2016 Review
Level of full compliance with reference to Hang Seng Index (“HSI”) / Non-HSI companies⁹	HSI: 33% Non-HSI: 36%	HSI: 40% Non-HSI: 35%
CPs with the lowest compliance rates in ascending order	<p>i. A.2.1 (64%): Separation of the roles of chairman and chief executive</p> <p>ii. A.4.1 (85%): Non-executive directors (“NEDs”) being appointed for a specific term</p> <p>iii. E.1.2 (90%): Chairman’s attendance at general meeting</p> <p>iv. A.5.1 (95%): Establishment of a nomination committee which comprises a majority of INEDs</p> <p>v. A.2.7 (95%): The chairman should hold meetings with NEDs without the presence of executive directors</p>	<p>i. A.2.1 (63%)</p> <p>ii. A.6.7 (80%) NEDs’ attendance at general meeting¹⁰</p> <p>iii. E.1.2 (86%)</p> <p>iv. A.4.1 (88%)</p> <p>v. A.5.1 (95%)</p>
Disclosed compliance rate of Recommended Best Practices (“RBPs”)	11%	8%

⁹ Out of 400 issuers selected, six are HSI companies.

¹⁰ CP A.6.7 is not included in the statistics in this section of the 2017/2018 Review because we do not consider it a deviation from the CP when one or more directors were absent from a general meeting. See “Consultation Conclusions on Review of the Corporate Governance Code and Related Listing Rules”, link at footnote 3.

Key Findings on Disclosure under MDRs and RDs¹¹

MDRs (Sections G to Q of the Code)	
G. Corporate Governance Practices A narrative statement on the issuer's application of the principles in the Code, whether it has complied or explained the CPs	99%
H. Directors' Securities Transactions Compliance with the Model Code	100%
I. Board of Directors (a) Composition of the board; (b) number of board meetings held; (c) director's attendance of board and general meetings; (d) alternate director's attendance of board/committee meetings; (e) a statement of the responsibilities, accountabilities and contributions of the board and management, their delegation to management; (f) non-compliance with rules 3.10 ¹² and 3.10A; (g) reasons why an INED is considered independent despite failing to meet rule 3.13; (h) relationship between board members; and (i) directors' training	67%
J. Chairman and Chief Executive Identity of the chairman and chief executive and whether their roles are separate	99%
K. Non-executive Directors The terms of appointment of the NEDs	97%
L. Board Committees¹³ (a) Role and function of the committee; (b) Composition of the committee; and (c) Number of meetings held during the year	91%
M. Auditor's Remuneration An analysis of remuneration of audit and non-audit services provided by auditors	72%
N. Company Secretary Where an external service provider is engaged as company secretary, the primary contact at the issuer	99%

¹¹ The previous reviews did not look into the disclosures under the MRDs and RDs.

¹² Rule 3.10 states that the board of directors of a listed issuer must include at least three INEDs and at least one of the INEDs must have appropriate professional qualifications or accounting or related financial management expertise.

¹³ We reviewed Section L.(d) (summary of work by board committees) from a qualitative perspective rather than a quantitative perspective as it is not possible to quantify the disclosures under this section. See paragraphs 31 to 35.

MDRs (Sections G to Q of the Code)	
O. Shareholders' Rights How shareholders can convene extraordinary general meeting and ways in which they can contact the board to make enquiries and put forward proposals	82%
P. Investor Relations Changes to constitutional documents during the year	100%
Q. Risk Management and Internal Control Whether the issuer has an internal audit function, how often the internal control systems are reviewed and a statement on the effectiveness of the systems	90%

RDs (Sections R to T of the Code, voluntary)		
	Disclosure in Corporate Governance Report	Disclosure in Annual Report
R. Share Interests of Senior Management¹⁴ The number of shares held by senior management	1%	7%
S. Investor Relations (a) Details of shareholders by type and aggregate shareholding; (b) Details of the last shareholders' meeting; (c) Indication of important shareholders' dates in the coming financial year; and (d) Public float capitalisation at the year end	1% 11% 7% 3%	98% 2% 39% 96%
T. Management Functions The division of responsibility between the board and management	92%	0%

¹⁴ Part XV of the Securities and Futures Ordinance (Cap. 571) ("**SFO**") requires (i) anyone interested in 5% or more of the shares in an issuer to disclose to the Exchange their share interests in that issuer; and (ii) directors and chief executives of an issuer to notify the Exchange of their interests in any shares of the issuer. So, if an individual is a member of the issuer's "senior management" as well as a shareholder or director within the meaning of the SFO, then the person would be required to disclose their share interests to the Exchange under the SFO.

CHAPTER 1: INTRODUCTION

Background

10. Since our first review of issuers' 2005 corporate governance practice disclosures, the Exchange has conducted nine periodic reviews culminating in the last report published in October 2017 in respect of the issuers' 2016 corporate governance reports.
11. Since the introduction of the Code in 2005, the corporate governance landscape has seen rapid changes in recent years, both in Hong Kong and internationally. The Exchange has conducted a number of substantive reviews of the Code and related Listing Rules to ensure that they are in tune with global developments and are adequate in addressing corporate governance issues and concerns.
12. In recent years we have seen greater investor interest in issuers' corporate governance as well as environmental and social reporting. The Securities and Futures Commission has published the "Principles of Responsible Ownership"¹⁵ in March 2016 which is aimed at encouraging investors to exercise responsibilities, particularly the right to speak and vote on matters that can influence the way in which a business is conducted. Investors and other stakeholders place ever higher expectations on directors and in particular, INEDs to perform their duties. Governance issues such as the actual independence of INEDs, their responsibilities and board diversity including gender have also gained a great deal of attention from investors and other stakeholders.
13. To help directors carry out their role more effectively, the Exchange also published, in July 2018, "Guidance for Boards and Directors" ("**Guidance**").¹⁶ The Guidance contains practical advice to boards and directors on their roles and responsibilities. It covers directors' duties and board effectiveness, board committees, board diversity - including gender diversity - and corporate governance for WVR Issuers.

Scope of 2017/2018 Review

14. The 2017/2018 Review covers corporate governance reports published by issuers with June 2017, December 2017 and March 2018 financial year ends. The scope of the 2017/2018 Review is wider than previous reviews. In addition to examining the issuers' compliance with the CPs, the 2017/2018 Review also reviewed Sample Issuers' disclosures under the Code's MDRs (Sections G to Q) and RDs (Sections R to T). We focused on the quality of the disclosures under Section L(d) on (i) the work of the board committees, i.e. the remuneration, nomination and audit committees; and (ii) disclosure of diversity policy.¹⁷

Sampling method

15. In light of the expanded scope discussed above, we have limited the 2017/2018 Review to a sample of 400 issuers so as to enable a more thorough examination of the Sample Issuers' corporate governance disclosures as well as their level of compliance.

¹⁵ Accessible at:

https://www.sfc.hk/web/EN/files/ER/PDF/Principles%20of%20Responsible%20Ownership_Eng.pdf

¹⁶ Accessible at:

http://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Other-Resources/Listed-Issuers/Corporate-Governance-Practices/guide_board_dir.pdf?la=en

¹⁷ See Chapter 3.

16. 2,118 issuers were listed as at 31 December 2017. We equally divided these issuers into large-, middle- and small-cap categories according to their market capitalisation. We then randomly selected 134 issuers from the large-cap category (“**Large-cap**”) and 133 issuers from each of the mid-cap (“**Mid-cap**”) and small-cap (“**Small-cap**”) categories and adjusted to include issuers with a year-end date of 30 June 2017 and 31 March 2018. Long suspended, recently de-listed and secondary listed issuers were not included in the Sample Issuers. The Sample Issuers constituted approximately 19% of all issuers as at 31 December 2017.
17. Of the 400 Sample Issuers, 16 (4%) were with June 2017, 300 (75%) were with December 2017 and 84 (21%) were with March 2018 financial year-ends.

Analysis

18. We analysed and set out:
 - (i) the compliance rates of the CPs (Chapter 2);
 - (ii) the quality of reporting in relation to MDRs and RDs. In particular, the disclosures in respect of board committees and board diversity policies together with our comments (Chapter 3); and
 - (iii) the deviations from the CPs, including the five CPs with the lowest compliance rates with their reasons and our comments (Chapter 4).
19. A summary of the statistics are set out in the Appendix.

CHAPTER 2: COMPLIANCE WITH CODE PROVISIONS

20. In this chapter, we will look at compliance rate of the CPs from the following perspectives:

- (a) overall;
- (b) market capitalisation; and
- (c) HSI versus non-HSI companies.

(a) Overall

21. 36% of Sample Issuers reported full compliance with all CPs, which is an increase of 2% from the 2016 Review.
22. 94% complied with not less than 75 CPs in the 2017/2018 Review, which is the same as the compliance rate of the issuers examined in the 2016 Review. Nearly all the issuers in the 2016 Review and the 2017/2018 Review complied with 70 or more CPs, out of 78. These results indicate that issuers' compliance with the Code remains constant. See Table A below for a more detailed breakdown.

Table A: Number of CPs disclosed by issuers as compliant

Number of CPs complied	2017/2018		2016	
	Number	Percentage	Number	Percentage
78	144	36%	485	34%
77	144	36%	515	36%
76	67	17%	251	18%
75	20	5%	86	6%
74	11	3%	59	4%
73	5	1%	12	1% ¹⁸
72	5	1%	11	1%
71	2	0% ¹⁹	2	0%
70	0	0%	2	0%
<70	2	0%	5	0%
Total	400	100% ²⁰	1,428	100%

(b) Market Capitalisation

23. We examined the Sample Issuers' compliance with all 78 CPs, i.e. full compliance, by reference to their market capitalisation. We found that Large-cap issuers achieved the highest rate of full compliance, at 43%, followed by Mid-cap at 35% and Small-cap at 30%.

¹⁸ The figures are rounded off to whole numbers. The actual percentages for issuers having complied with: 73 CPs is 0.8%, 72 CPs is 0.7%, 71 is 0.1%, 70 is 0.1% and 0.4% for compliance below 70 CPs, respectively.

¹⁹ The figures are rounded off to whole numbers. The actual percentage for the Sample Issuers having complied with 71 and below 70 CPs were both 0.5%.

²⁰ The total percentage does not amount to 100% due to rounding.

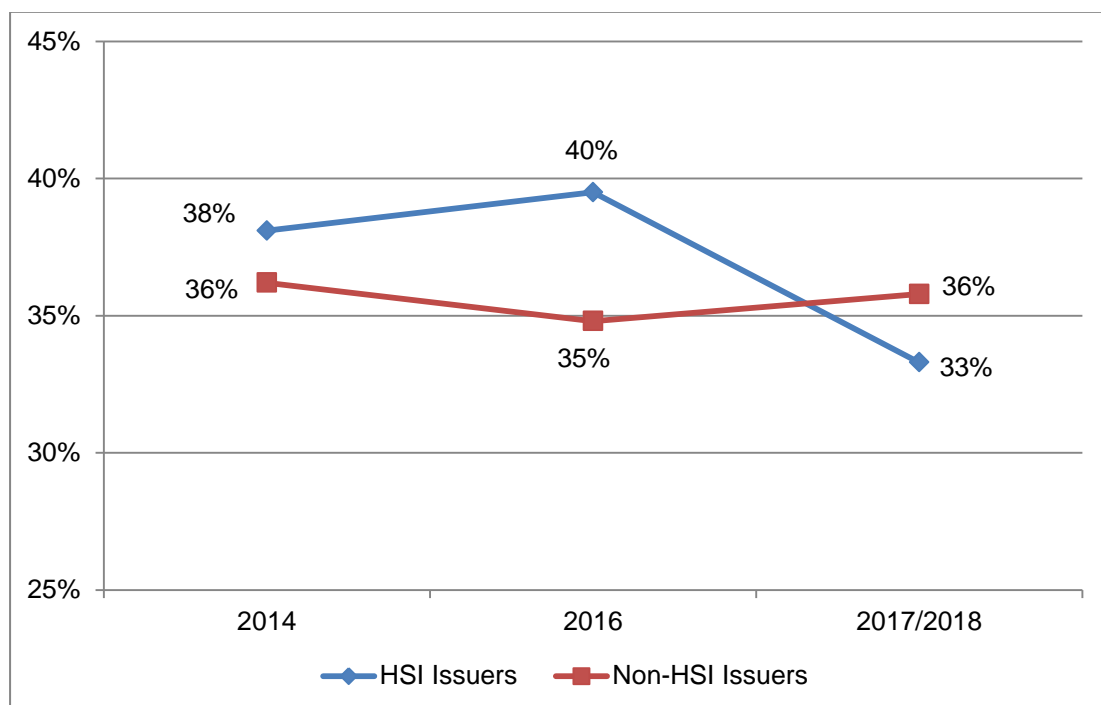
(c) HSI versus non-HSI companies

24. We examined the Sample Issuers' compliance with all 78 CPs, i.e. full compliance, by reference to whether they were HSI and non-HSI companies. We found that:

- (i) The full compliance rate for HSI companies was 33%, a drop of 7% from 40% in the 2016 Review; and
- (ii) Non-HSI companies' full compliance rate was 36%, which was higher than that of the HSI companies and slightly higher than the figure in the 2016 Review. See Chart A.

25. We attribute the apparent drop of HSI's compliance rate to the small sample size (six of the Sample Issuers were HSI issuers) in the 2017/2018 Review.

Chart A: Percentage of issuers with full compliance (by HSI and non-HSI companies)



CHAPTER 3: MANDATORY DISCLOSURE REQUIREMENTS AND RECOMMENDED DISCLOSURES

26. In addition to examining the Sample Issuers' compliance with the CPs, the 2017/2018 Review also reviewed Sample Issuers' disclosures under the Code's MDRs (Sections G to Q) and RDs (Sections R to T).

27. There are eight MDRs and three RDs which are set out below:

MDRs

- G. Corporate Governance Practices
- H. Directors' Securities Transactions
- I. Board of Directors
- J. Chairman and Chief executive
- K. Non-executive Directors
- L. Board Committees
- M. Auditors Remuneration
- N. Company Secretary
- O. Shareholders' Rights
- P. Investor Relations
- Q. Risk Management and Internal Control

RDs

- R. Share Interests of Senior Management
- S. Investor Relations
- T. Management Functions

MDRs

Overall

Findings

28. Sample Issuers' disclosures under the MDRs demonstrated a high level of compliance, with 90% or more of the Sample Issuers complied with Sections G, H, J, K, N, P, Q and L.(a)-(c)²¹. However, the compliance level of Sections I, M and O were relatively low, ranging from 67% to 82%. We found that disclosures under those sections only partially responded to the disclosure requirements and they were therefore considered "non-compliant". For instance:

- Section I.(i) requires disclosure of each director's training record. However, a number of the Sample Issuers merely provided a statement as to whether the directors had participated in continuous trainings without specifying how each director, by name, had complied with the training requirements.
- Section M requires an analysis of remuneration in respect of audit and non-audit services provided by the auditors. We observed that some Sample Issuers failed to disclose non-audit services provided by auditors.

²¹ See footnote 13.

- Section O(c) concerns shareholders' rights and it calls for issuers to provide procedures for putting forward proposals at shareholders' meetings. We observed that a number of the Sample Issuers failed to do so.

Our Comments

29. We note that where an MDR calls for information on several matters, the Sample Issuers may have inadvertently omitted one or more points. Issuers should pay attention to the detailed requirements under the MDRs and make clear and complete disclosures or provide reasons for non-disclosure in respect of each matter so as to avoid breach of the Listing Rules. Going forward, we will continue to review issuers' compliance in this area and may take further actions against individual issuers in respect of the breach as appropriate.
30. For the 2017/2018 Review, we focused our comments on disclosures made about the summary of work of the board committees as we observed a varied level and quality of disclosure in this area. We also examined the disclosures relating to board diversity as we noted from previous reviews that some issuers did not disclose their board diversity policies despite claiming to have such policies whilst others may have provided "boiler-plate" style policies. We consider these areas of disclosures important and to an extent, demonstrate issuers' corporate governance efforts.

Summary of Work of the Board Committees

Findings

31. Most Sample Issuers²² were able to state the roles and functions²³, composition²⁴ and details regarding committee meetings²⁵. However, the quality of disclosure was varied in areas which call for narrative statements or require policy discussions.
32. We observed a small number of reports with excellent quality of disclosures which provided clear and detailed explanations of the responsibilities and performance of each of the board committees. At the other end of the spectrum, a small number of reports showed unsatisfactory quality of disclosure. These reports usually did not separate the roles and functions of the various board committees and some were without any narratives on the committees' work during the year. They also tended to resort to sweeping statements or boilerplate phrases when describing their policies and criteria.
33. Clearly not all of the items listed in MDR Section L(d) (summary of work by board committees) would have been applicable to all issuers during the financial year, we observed that the response to this disclosure requirement tended to focus on items relating to business activities during the year. Taking the Remuneration Committee as an example, most Sample Issuers²⁶ discussed policies for remuneration, such as remuneration bands and share option schemes applicable to directors. We noted that a majority of the Sample Issuer²⁷ did not make disclosures regarding the approval of directors' service contracts.

²² Over 95% for audit committee, remuneration committee and nomination committee.

²³ Section L.(a) of the Code

²⁴ Section L.(b) of the Code

²⁵ Section L.(c) of the Code

²⁶ More than 70%.

²⁷ Nearly 90%.

Our Comments

34. Board committees including audit, remuneration and nomination committees and corporate governance function play important roles in ensuring the issuers' corporate governance structures are sound and effective. They provide support to the board with delegated authorities to carry out functions according to their terms of references. Good quality disclosure in this area helps shareholders and investors to understand the work of the board committees. We encourage issuers to provide informative summaries of the work carried out by each of the board committees to promote transparency. It is hoped and expected that such transparency would in turn bring about improved accountability and board effectiveness.
35. On the absence of disclosure of directors' service contracts, we appreciate that an issuer may not have directors' service contracts requiring approval within the reporting period. For clarity, it may be helpful to make a statement to that effect. However, issuers should not omit the disclosure if approval of such contracts were part of the remuneration committee's work during the relevant reporting period.

Board Diversity Policy

Findings

36. MDR Section L.(d)(ii) requires issuers to disclose their board diversity policy or a summary of the policy (if they have one)²⁸, including any measurable objectives. A majority of the Sample Issuers confirmed that the board had adopted a board diversity policy. A small number of the Sample Issuers were able to go beyond the requirements in the Code and provided a skills matrix to demonstrate existing composition of the board as well as describing the matters taken into account in their board diversity policies. Nevertheless, a small number of the Sample Issuers at the other end of the spectrum reported that they complied with the CP (A.5.6, i.e. that they have a diversity policy) but failed to disclose the policy.

Our Comments

37. Issuers should note that not explaining a deviation from a CP is a breach of the Listing Rules. We have contacted Sample Issuers that failed to disclose their diversity policies without giving considered explanations individually and will take follow up action as appropriate.
38. It is also important to note that for a diversity policy to be effective, it should include measurable objectives that an issuer has set for implementing the policy and disclose the progress on achieving those objectives. We appreciate that diversity milestones vary from company to company, depending on the nature of the business, stage of development and diversity profile of the board. Issuers are encouraged to determine their measurable objectives to reflect the particular needs of the board and disclose any milestones they have achieved.
39. For the period covered by the 2017/2018 Review, the requirement to have a board diversity policy and to disclose the policy or provide a summary of it was a CP which will be upgraded to a Rule²⁹ effective on 1 January 2019. Issuers are reminded as from 1

²⁸ For the period covered by the 2017/2018 Review, the requirement to have a board diversity policy was a CP, subject to "comply or explain".

²⁹ Main Board Rule 13.92/GEM Rule 17.104.

January 2019, they must have a board diversity policy and they must also disclose the policy or a summary of it in their corporate governance reports.

RDs

Findings

40. The obligation to disclose under RDs is voluntary. Nevertheless, as some information called for under the RDs is also relevant and required in other parts of the Listing Rules, we found disclosures in relation to this section were made elsewhere rather in the corporate governance reports. For example, a large majority of the Sample Issuers³⁰ made disclosures on Sections S(a), i.e. details of shareholder by type; and S(d), i.e. public float capitalisation, in their annual reports instead of their corporate governance reports.
41. As for Section R, a majority of the Sample Issuers³¹ did not make disclosures on the number of shares held by senior management.³² As for Section T, i.e. division of responsibility between board and management, a majority of the Sample Issuers³³ made disclosures in their corporate governance reports.

Our comments

42. We appreciate the need to minimise repeated disclosures but would recommend that issuers should link the relevant disclosures made elsewhere by cross-referencing to ensure that shareholders and other stakeholders can easily identify the information required or recommended in the corporate governance reports.

³⁰ 98% for Section S.(a) and 96% for Section S.(d).

³¹ Approximately 92%

³² See footnote 14.

³³ Approximately 92%

CHAPTER 4: ANALYSIS OF DEVIATIONS

43. The compliance rates with all CPs are set out in Table 1 of Appendix. The ten CPs with the lowest compliance rates and the percentage of issuers that deviated from the CPs are set out in Chart 1 of Appendix.

The five CPs with the lowest compliance rates and their reasons

44. The five CPs with the lowest compliance rates were A.2.1, A.4.1, E.1.2, A.5.1 and A.2.7. The compliance rates of these CPs are similar to those of the 2016 Review. See Table B.

Table B: Five CPs with the lowest compliance rates in 2017/2018 against 2016

CPs		Compliance rates	
		2017/2018 Review	2016 Review
A.2.1	Separation of the roles of chairman and chief executive	64%	63%
A.4.1	NEDs being appointed for a specific term, subject to re-election	85%	88%
E.1.2	Chairman's attendance at AGM	90%	86%
A.5.1	Establishment of a nomination committee which is chaired by the chairman of the board or an INED	95%	95%
A.2.7	Chairman's annual meeting with NEDs without the executive directors present	95%	96%

45. The reasons for the top five most common deviations of the 2017/2018 Review are examined further below.

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

Summary of explanations

46. The common reasons for deviation from this CP were similar to those disclosed by the issuers in the 2016 Review. The most common reason for departure from the CP was that vesting the roles of chairman and chief executive in the same person provided the group with strong and consistent leadership and allowed for more effective formulation and implementation of long-term business strategies.
47. For the 2017/2018 Review, we focused on whether the issuers have addressed the issue of lacking in checks and balance where the roles of chairman and chief executive were combined. We observed that over half of the Sample Issuers had considered the governance issue of balance of power and authority on the board. Their explanations included that the structure of the company was sufficient to address this issue. Some gave examples of such structures including strong independent elements on the board, delegation of authorities to management, supervision by the board and board

committees. A few of the Sample Issuers made bare assertions that their structures would not impair the balance of power but offered no details.

48. Other reasons included that the person holding the dual capacity of chairman and chief executive had profound experience and knowledge in operations of the business; the decisions were collectively made by members of the board; and practical considerations including the size and business nature required the company to deviate from this CP.
49. There were cases where the Sample Issuers did not have the position of a chairman or chief executive. This reason was adopted by 16% of the Sample Issuers. Amongst these Sample Issuers, some explained that the position of chairman or chief executive was vacant because the former chairman or chief executive resigned. Some of them have subsequently complied during the year by recruiting a replacement.
50. A very small number of the Sample Issuers merely stated that they have rectified their deviation from this CP after the resignation of the individual who undertook the combined roles of chairman and chief executive by appointing separate individuals for the roles.

Our comments

51. In the November 2015 review report³⁴, we recommended issuers that decided to deviate from the CP requiring separation of the roles of chairman and chief executive to provide explanations on how they have addressed the governance issue of the leadership's lack of checks and balances. Compared with previous reviews, we observed an improvement in the explanations given by the Sample Issuers for a deviation from this CP.
52. It is important to note that the separation of the roles of the chairman and chief executive promotes good corporate governance. In addition to balancing the powers and authority on the board, thereby mitigating the risk of "groupthink", it also promotes stability in a company. By separating functions, the chief executive can focus on strategy, operations, and organisational issues while the chairman can oversee management, lead the board, and promote good governance.
53. The statistics relating to the reasons given for the deviation from this CP are set out in Table 2 of Appendix.

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

Summary of explanations

54. All issuers deviated from this CP explained that the NEDs are subject to retirement by rotation³⁵ in accordance with their articles of association, by-laws or equivalent constitutional documents.

³⁴ See footnote 2.

³⁵ Retirement by rotation generally refers to a process whereby at each annual general meeting one third of the directors must retire from their position and seek re-election as a director.

Our comments

55. Internationally it is widely recognised as good corporate governance practice for NEDs to be appointed for a specific term, preferably 12 months.³⁶ Retirement by rotation (as required in CP A.4.1) is another measure that seeks to limit a director's tenure.
56. The main purpose of these measures is to prevent entrenchment by ensuring that companies periodically seek shareholders' re-election of directors (NEDs in the case of CP A.4.1).
57. We therefore believe that issuers should treat CP A.4.1 and the practice of retirement by rotation separately, and should specify the period of appointment of NEDs at intervals of no more than three years.

E.1.2 The chairman of the board should attend the annual general meeting. He should also invite the chairmen of the audit, remuneration, nomination and any other committees (as appropriate) to attend. In their absence, he should invite another member of the committee or failing this his duly appointed delegate, to attend. These persons should be available to answer questions at the annual general meeting. 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 requires independent shareholders' approval. An issuer's management should ensure the external auditor attend the annual general meeting to answer questions about the conduct of the audit, the preparation and content of the auditors' report, the accounting policies and auditor independence.

Summary of explanations

58. Issuers that did not comply with this CP commonly stated that the person(s) required by this CP to attend the annual general meeting ("AGM") were unable to do so as they had other commitments (mainly business engagements). The statistics relating to the reasons given for the deviation from this CP are set out in Table 3 of Appendix.
59. A breakdown of whether it was the chairman or the chairman of the committee(s) who failed to attend the AGM is at Table 4 of Appendix. In a vast majority of cases, it was the chairman of the board who failed to attend the AGM.

Our comments

60. We are pleased to see an improvement to the compliance rate of this CP (10% deviated from this CP in the 2017/2018 Review and 14% in the 2016 Review).
61. An AGM is a major corporate event. It allows shareholders, company management and directors to examine and make decisions on important affairs of the company. It is also a

³⁶ Code Provision B.7.1 of the UK Corporate Governance Code provides that "All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years." In the US, the Institutional Shareholder Services Inc.'s press release on its 2015 Board Practices Study states: "The majority of companies in the S&P 1500 hold annual elections for directors. While this has been the norm for a number of years at larger companies, for the first time since our analysis began in 1996, more than 50 percent of Small Cap companies have declassified their boards and turned to annual elections for directors."

main channel of communication between the board and the shareholders.

62. The chairman of the board is responsible for ensuring that the board works effectively when performing its responsibilities. As the leader of the board, the chairman is generally expected to prioritise the issuer's AGM over and above their other commitments.

A.5.1 Issuers should establish a nomination committee which is chaired by the chairman of the board or an independent non-executive director and comprises a majority of independent non-executive directors.

Summary of explanations

63. Many issuers that deviated from this CP stated that it was in the best interest of the company that the board collectively reviewed and approved the appointment of new directors. We noted that some of the Sample Issuers may have used "boilerplate" responses since their use of language for this reason was very similar.
64. A few of the Sample Issuers deviated from this CP because the committee did not comprise a majority of INEDs as a result of recent resignations. Among these Sample Issuers, some were still seeking suitable candidates, whilst others had already rectified the non-compliance at the date of their annual reports.

Our comments

65. The principal responsibility of the nomination committee is to review the size, structure and composition of the board, and to identify and recommend appropriate candidates for election or re-election to the board. The work of the committee has a tremendous influence on the future success of the board and the issuer.
66. Where an issuer chooses to depart from this CP, it should set out the circumstances that are unique to the company to explain such departure rather than using "boilerplate" language so as to add value to the disclosure.
67. Issuers should note that with the new corporate governance regime becoming effective on 1 January 2019, greater responsibility will be imposed on the nomination committee (or the board, if the issuer does not have a nomination committee). For instance, the Code will require disclosure on the process of identifying INEDs, the proposed INED's time commitment and their contribution to the board including diversity, etc.³⁷ Establishing a nomination committee will focus the board's efforts on these issues. Issuers that do not currently have a nomination committee should seriously consider establishing one.

³⁷ See paragraph 12.

A.2.7 The chairman should at least annually hold meetings with the non-executive directors (including independent non-executive directors) without the executive directors present.

Summary of explanations

68. The most common reason Sample Issuers gave for departure from the CP was that NEDs could individually communicate their views to the chairman. The next most popular reason was that the chairman/issuer had delegated to the company secretary the responsibility to gather questions from NEDs.
69. Other reasons included (i) the chairman was also an executive director; (ii) the position of chairman was vacant or the issuer did not have the position of a chairman; and (iii) no meeting was held because the chairman had other engagements.

Our comments

70. We believe that there should be a forum for the chairman to meet with INEDs even if the chairman is not an INED. The presence of the chairman encourages INEDs' attendance and the meetings tend to result in more useful discussions.
71. Although NEDs (including INEDs) may have other means of communication with the chairman, periodic meetings would provide a forum for the chairman to communicate with, and to listen to their views, in the absence of the company's senior management and executive directors.
72. Amendment to CP A.2.7 will become effective on 1 January 2019 which will require the chairman to hold meetings with the INEDs without the presence of other directors at least annually.
73. The statistics relating to the reasons given for the deviation from this CP are set out in Table 5 of Appendix.

APPENDIX: SUMMARY OF STATISTICS

Table 1: Compliance rate with each CP

Code Provision	2017/2018	2016
	% of compliance	% of compliance
A.1.1	98%	98%
A.1.2	100%	100%
A.1.3	100%	99%
A.1.4	100%	100%
A.1.5	100%	100%
A.1.6	100%	100%
A.1.7	100%	100%
A.1.8	98%	98%
A.2.1	64%	63%
A.2.2	100%	100%
A.2.3	100%	100%
A.2.4	100%	100%
A.2.5	99%	99%
A.2.6	100%	100%
A.2.7	95%	96%
A.2.8	100%	100%
A.2.9	100%	100%
A.3.1	100%	100%
A.3.2	100%	100%
A.4.1	85%	88%
A.4.2	96%	96%
A.4.3	100%	99%
A.5.1	95%	95%
A.5.2	96%	97%
A.5.3	96%	98%
A.5.4	96%	98%
A.5.5	100%	100%
A.5.6	100%	100%
A.6.1	100%	100%
A.6.2	100%	100%
A.6.3	100%	100%
A.6.4	100%	100%
A.6.5	100%	100%
A.6.6	100%	100%
A.6.7	85%	80%
A.6.8	100%	100%
A.7.1	100%	100%
A.7.2	100%	100%
A.7.3	100%	100%
B.1.1	100%	100%
B.1.2	100%	99%
B.1.3	100%	100%
B.1.4	100%	100%

	2017/2018	2016
Code Provision	% of compliance	% of compliance
B.1.5	100%	100%
C.1.1	100%	100%
C.1.2	99%	99%
C.1.3	100%	100%
C.1.4	100%	100%
C.1.5	100%	100%
C.2.1	100%	100%
C.2.2	100%	100%
C.2.3	100%	100%
C.2.4	100%	100%
C.2.5	99%	97%
C.3.1	100%	100%
C.3.2	100%	100%
C.3.3	100%	99%
C.3.4	100%	100%
C.3.5	100%	100%
C.3.6	100%	100%
C.3.7	100%	100%
D.1.1	100%	100%
D.1.2	100%	100%
D.1.3	100%	100%
D.1.4	99%	98%
D.2.1	100%	100%
D.2.2	100%	100%
D.3.1	100%	100%
D.3.2	100%	100%
E.1.1	100%	100%
E.1.2	90%	86%
E.1.3	100%	100%
E.1.4	100%	100%
E.2.1	100%	100%
F.1.1	100%	99%
F.1.2	100%	100%
F.1.3	100%	99%
F.1.4	100%	100%

Chart 1: The ten CPs with the lowest compliance rates

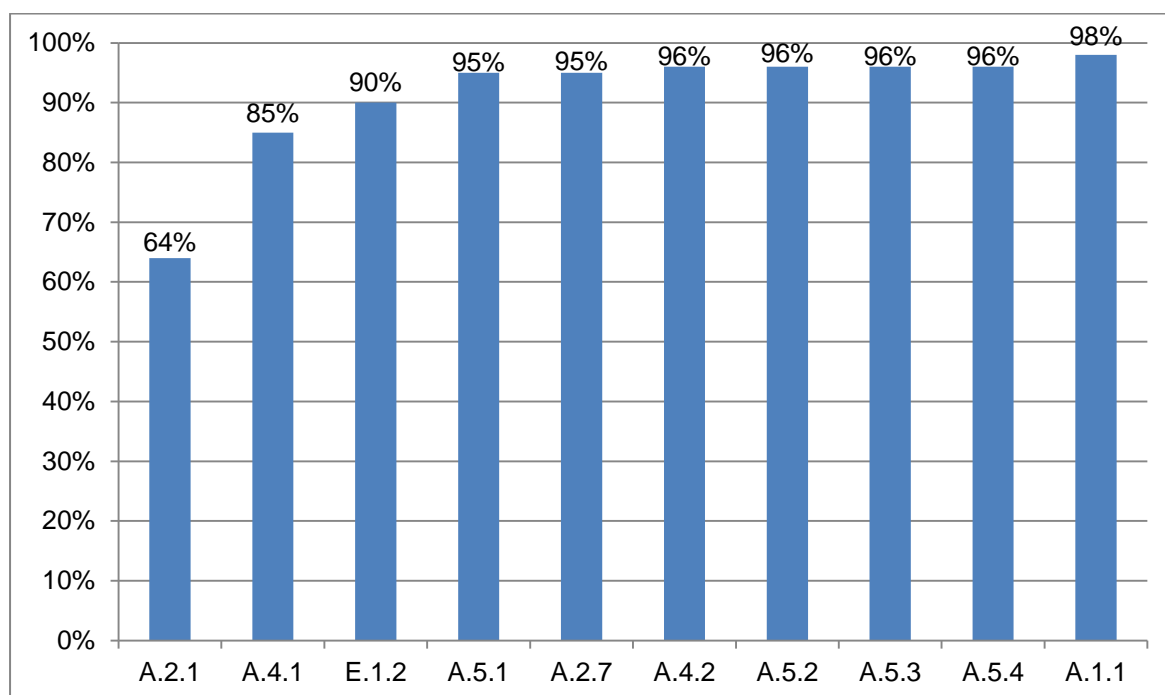


Table 2: Reasons disclosed for not separating the roles of Chairman and Chief Executive (CP A.2.1)

Reasons ³⁸	Number of issuers	% of issuers deviated from CP A.2.1
The same person provides the Group with strong and consistent leadership, allows for more effective planning/formulation and execution/implementation of long-term business strategies.	89	61%
The issuer had considered the governance issue of balance of power and authority on the board and believed that the structure of the company, including strong independent elements in the board, delegation of authorities to management, supervision by the board and board committees, was sufficient to address this potential issue.	77	53%
The board has confidence in the person who acts as chief executive and chairman, e.g. because the person is knowledgeable, well-known and/or has a good understanding of the operations of the issuer	25	17%
Contributions are made by all executive directors/independent nonexecutive directors, who bring different experience and expertise and who meet regularly to discuss issues affecting the issuer's operations.	24	17%

³⁸ Sample Issuers may have given more than one of the reasons listed in Table 2.

Reasons	Number of issuers	% of issuers deviated from CP A.2.1
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.	4	3%
Others	23	16%

Table 3: Reasons disclosed for absence of chairman of the board/board committees at the annual general meeting (CP E.1.2)

Reasons	Number of issuers	% of issuers deviated from CP E.1.2
Business engagement	24	59%
Health/other personal reason	4	10%
Others (including overseas engagement, resignation and retirement)	12	29%
Unspecified	1	2%
Total	41	100%

Table 4: Breakdown on parties unable to attend the annual general meeting (CP E.1.2)

Reasons	Number of issuers	% of issuers deviated from CP E.1.2
Chairman of the board	34	83%
Chairman of board committee(s)	4	10%
All of the above	3	7%
Total	41	100%

Table 5: Reasons disclosed for the chairman not holding meetings with NEDs without the present of executive directors (CP A.2.7)

Reasons	Number of issuers	% of issuers deviated from CP A.2.7
NEDs can individually communicate their views to chairman	5	25%
The company secretary is delegated responsibility to gather concerns and questions from NEDs	4	20%
The chairman is an executive director	3	15%
There is no chairman	3	15%
The chairman had other engagement	2	10%
Others	3	15%
Total	20	100%

