

Analysis of 2019 Corporate Governance Practice Disclosure



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INTRODUCTION

1. The Stock Exchange of Hong Kong Limited (“**Exchange**”) has completed its eleventh review¹ (“**2019 Review**”) of issuers’ compliance with the Corporate Governance Code and Corporate Governance Report (“**CG Code**”).
2. In the 2019 Review, we analysed corporate governance reports for the financial year ended 31 December 2019 reviewing a sample of 400 issuers (“**Sample Issuers**”). We also studied disclosures on re-election of an independent non-executive director (“**INED**”) who has served more than nine years (a “**Long-serving INED**”)² or election of an INED holding their seventh (or more) directorship (an “**Overboarding INED**”)³.
3. The review of issuers’ corporate governance practice is part of our continuing effort to maintain high corporate governance standards amongst issuers. By identifying improvement areas in issuers’ corporate governance reporting and providing guidance, it is hoped and expected that this will assist and lead to enhancements in our issuers’ reporting practices.

Scope of the 2019 Review

4. The 2019 Review is focused on the following areas:
 - (a) Re-election of Long-serving INEDs;
 - (b) Election of Overboarding INEDs; and
 - (c) Board diversity, nomination of and selection criteria for directors.
5. Having a strong independent element on the board is key to an effective board. It is of utmost importance to ensure that INEDs continue to make this vital contribution to the board’s function. In the 2019 Review, we looked into issuers’ explanations on re-election of Long-serving INEDs on why the board believes those INEDs are still independent and should be re-elected.
6. Since 2019, issuers proposing to elect an Overboarding INED as an INED are required to explain why the board believes that such individual would still be able to devote sufficient time to the board. Issuers are also required to disclose their board diversity policy and nomination policy in their corporate governance reports. These requirements are considered in this review for the purpose of gauging issuers’ compliance with these new requirements.
7. We also share our findings and recommendations on issuers’ compliance with the CG Code, including an analysis of the five Code Provisions (each a “**CP**”) with the lowest compliance rates (the “**Five Least Complied CPs**”) and their reasons, and common pitfalls identified in issuers’ disclosures. It is hoped that this will provide more clarity in the scope of explanation expected of where there was a deviations from these CPs.

¹ Since our first review of issuers’ 2005 corporate governance practice disclosures, we have conducted ten periodic reviews culminating in the last report published in November 2018 in respect of the issuers’ 2017/2018 corporate governance reports.

² Pursuant to CP A.4.3, an issuer is required to explain why the board believes that an INED whom has served more than 9 years is still independent and should be re-elected.

³ Pursuant to the revised CP A.5.5 which came into effect on 1 January 2019, an issuer is required to explain why the board believes a proposed Overboarding INED would still be able to devote sufficient time to the board.

Our observations and recommendations

Re-election of INEDs serving nine years or more (Part IIA)

8. As of June 2020, 1,654 (20%) INED directorships (out of 8,170) were occupied by Long-serving INEDs⁴. These directors sit across one-third (34%) of issuers listed on the Exchange. There were 166 issuers (7%) where every one of their INEDs had served nine years or more.
9. Most issuers quoted satisfaction of the independence criteria set out in Main Board Rule 3.13⁵ (“**Rule 3.13 Independence Criteria**”) as confirmation of the Long-serving INED’s independence. This by itself cannot address whether the Long-serving INED remains capable of bringing fresh perspectives and independent judgment to the board despite familiarity with the company’s affairs and management. Issuers must balance the Long-serving INED’s expertise and cumulated experience with the company against the ability to stay independent, the necessity of board refreshment and succession planning. Disclosures should demonstrate the rigour of the nomination process, starting from the identification of new potential candidates to the final determination to re-elect a Long-serving INED.

Overboarding of INEDs (Part IIB)

10. As of June 2020, 42 directors were holding seven or more directorships in 288 issuers listed in Hong Kong.
11. Most issuers justified the appointment of an Overboarding INED by listing factors considered by the board (e.g. the Overboarding Director’s unique expertise), without disclosing how the board could be satisfied with the apparent lack of time on the part of the Overboarding INED.

Board diversity, nomination and selection of directors (Part IIC)

12. Almost all Sample Issuers disclosed their policy on board diversity. We are pleased to note that a small portion of Sample Issuers also disclosed objectives for enhancing board diversity. Some issuers however stated that they did not set any measurable objectives as their boards are sufficiently diverse.
13. It is important for issuers to set and disclose measurable objectives on board diversity as they demonstrate the board’s commitment to board diversity, and allow the board and external stakeholders to track the company’s progress in this area.

Compliance with the CG Code (Part IIIB)

14. We are pleased to note that all Sample Issuers have complied with at least 73 out of 78 CPs, and 41% of them have fully complied with all CPs (previous review⁶: 36%).

⁴ Based on a total of 2,443 issuers as of June 2020.

⁵ GEM Rule 5.09.

⁶ Our tenth review of issuers’ compliance with the CG Code of sample issuers with a financial year-end date of 31 December 2017, 30 June 2017 and 31 March 2018 (hereinafter referred to as the “**2017/2018 Review**”). See HKEX, Analysis of Corporate Governance Practice Disclosure in June and December Year-end 2017 and March year-end

Explanations for deviations were given in substantially all occasions where there was deviation from a CP⁷. The results indicate an improvement in issuers' compliance with the CG Code.

15. The Five Least Complied CPs were:
 - (a) Separation of the roles of chairman and chief executive (CP A.2.1),
 - (b) Attendance of the annual general meeting (“**AGM**”) by chairmen of the board and board committees (CP E.1.2),
 - (c) Non-executive directors (“**NEDs**”) being appointed for a specific term, subject to re-election (CP A.4.1),
 - (d) Disclosure of dividend policy (CP E.1.5), and
 - (e) Establishment of a nomination committee (“**NC**”) comprising a majority of INEDs (CP A.5.1).
16. An analysis of reasons given for each of the Five Least Complied CPs is set out in Part IIIB. While separating the roles of chairman and chief executive remains a challenge for issuers (with a compliance rate of 64%), all the remaining CPs were complied with by a vast majority of the Sample Issuers (over 90%).
17. Disclosure of dividend policy, with a compliance rate of 94%, is amongst the Five Least Complied CPs, most likely due to individual issuers' oversight of this recently introduced CP in January 2019. Transparent and independent oversight by the NC regarding board nomination and recruitment, diversity and succession planning is key to promote better practice and standards. This is recognised by our issuers, and 95% of the Sample Issuers have already established a dedicated NC to oversee these matters.

Common pitfalls (Part IIIC)

18. Issuers are reminded that information called for under the mandatory disclosure requirements (“**MDRs**”) of the CG Code must be covered in the corporate governance report. Issuers should include a negative statement if they consider any of the MDRs inapplicable to them for the relevant reporting year.
19. Some MDRs require disclosure on a number of different issues. Issuers are reminded to carefully go through each paragraph / sub-paragraph of the MDRs to ensure that all required information are properly disclosed.
20. We have also set out other MDRs that are commonly overlooked or incorrectly disclosed. Please refer to Part IIIC for details.

Continuous review of the corporate governance framework

21. The promotion of good corporate governance and diversity are our key focuses, as we seek to further enhance the quality of our listed issuers and of our market. We are currently conducting a review of our corporate governance framework and expect to put

2018 Annual Reports, November 2018.

⁷ Less than 6% of the Sample Issuers did not disclose or give reasons for deviation from a CP.

forward proposals for public consultation.

I. SAMPLING METHOD

22. Our past reviews mainly focused on issuers' disclosure in their corporate governance reports. Given our focus on the (re-)election of Long-serving INEDs and Overboarding INEDs this year, we have also reviewed issuers' explanations for the (re-)election of Long-serving INEDs and Overboarding INEDs contained in their circulars.

Sampling method

Re-election of a Long-serving INED

23. We reviewed disclosures made by 60 issuers (selected on a random basis) that had proposed a resolution to re-elect a Long-serving INED during the period from 1 January 2019 to 31 August 2020.

Election of an Overboarding INED

24. We reviewed disclosures made by 60 issuers (selected on a random basis) that had proposed a resolution to elect an Overboarding INED during the period from 1 January 2019 to 30 April 2020.

Corporate governance report

25. As at 31 December 2019, 2,449 issuers were listed on the Exchange. We divided these issuers equally into three groups, large-, middle- and small-cap categories according to their market capitalisation. We then randomly selected 133 issuers, 133 issuers and 134 issuers from the large-cap category ("**Large-cap**"), mid-cap ("**Mid-cap**") and small-cap ("**Small-cap**") categories respectively. Long suspended, recently de-listed and secondary listed issuers were not included in the Sample Issuers. The Sample Issuers constituted approximately 16.3% of all issuers as at 31 December 2019.

II. SPECIFIC FOCUS AREAS

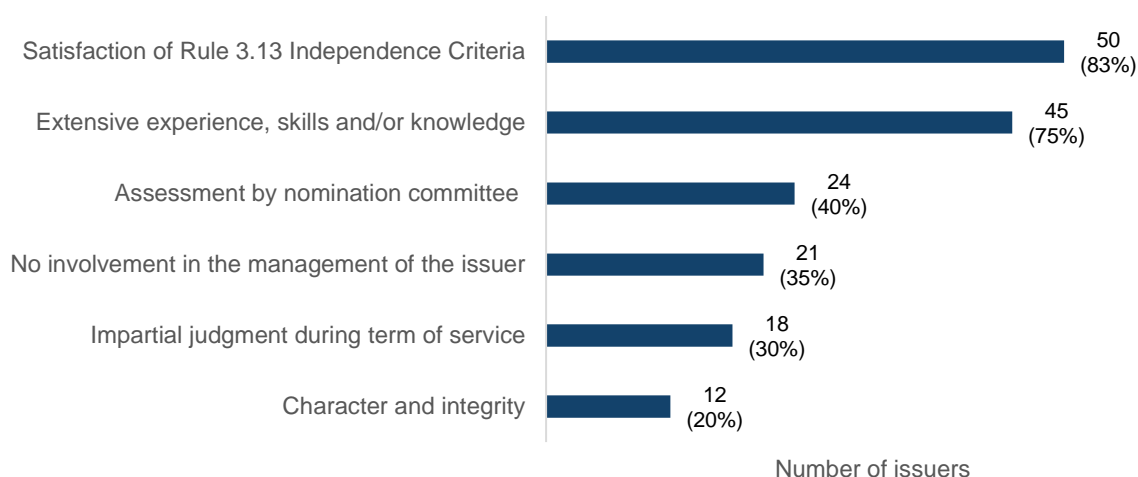
A. Re-election of independent non-executive directors serving nine years or more

26. Principle A.3 of the CG Code provides that the board should have a strong independent element. “Independent” in this context refers to the ability of an INED to provide a fresh pair of lens that help to scrutinise some of the board’s major decisions. Where an INED served on a board for an extended period of time, they may become too close to an issuer’s management and may lose their objectivity and independence.
27. CP A.4.3 requires issuers to put forward a separate resolution for shareholders’ approval for further appointment of an INED who has served more than nine years. The papers to shareholders accompanying that resolution should include the reasons why the board believes the Long-serving INED is still independent and should be re-elected.
28. The purpose of this CP is to allow shareholders an opportunity to consider whether the INED is still capable of bringing a fresh perspective and independent judgment to bear on issues of strategy, performance, accountability, key appointments and standards of conduct.

Findings

29. As of June 2020, 1,654 board directorships were occupied by Long-serving INEDs. There were 166 issuers where every single one of their INEDs has served nine years or more.
30. The explanations given for re-electing a Long-serving INED are set out in Chart 1 below.

Chart 1: Reasons for believing that an INED serving nine years or more to be independent (CP A.4.3)^{8,9}



⁸ The percentages do not add up to 100% as most issuers referred to more than one reason in their explanations.

⁹ The figure for “Satisfaction of Rule 3.13 Independence Criteria” includes issuers whom have referred to (i) the annual independence confirmation provided by the INED and/or (ii) the board’s assessment of the INED’s independence with reference to the Rule 3.13 Independence Criteria.

Our comments

31. Many issuers viewed satisfaction of Rule 3.13 Independence Criteria (which primarily focuses on a director's actual or potential conflict of interest) as equivalent to confirmation of a director's ability to continue to bring in fresh perspectives and independent judgment. This obviously cannot be the case as Rule 3.13 Independence Criteria set out circumstances where an INED's independence is most likely to be questioned without assessing the INED's mindset.
32. While the Long-serving INEDs' history with the issuer can be an advantage, issuers are reminded to balance that benefit against the ability of that INED to stay independent and the necessity of board refreshment and succession planning. Effective succession planning involves managing the staggered retirement of directors to ensure continuity¹⁰.
33. In the case of electing Long-serving INEDs, it is even more important for issuers to demonstrate the rigour of the nomination process. It should be transparent to the shareholders the efforts that went into identifying potential INEDs, how the Long-serving INED would still be able to bring fresh perspectives to the board despite their tenure; how succession planning can be ensured notwithstanding the re-election of the Long-serving INED and finally the evaluation conducted by the board.

B. Overboarding of independent non-executive directors

34. Being a director (whether executive or not) of a listed company requires appropriate time commitments. While the number of directorships a person can hold without compromising their performance varies from person to person, most investors consider directors holding seven directorships unable to devote sufficient time to each of their board.¹¹
35. From 1 January 2019, CP A.5.5 requires an issuer to, when proposing a resolution to elect an individual as an INED who will be holding their seventh (or more) listed company directorship, set out in its circular to shareholders why the board believes the proposed INED would still be able to devote sufficient time to the board. Disclosures made should be sufficiently clear to justify the board's recommendation and enable shareholders to make better informed voting decisions at a general meeting.

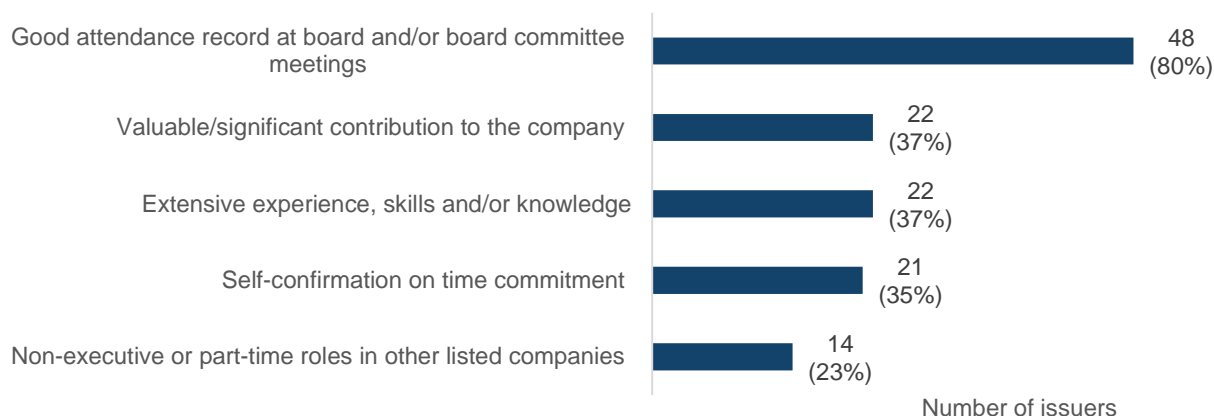
Findings

36. As of June 2020, 42 directors were holding seven or more directorships in 288 issuers listed in Hong Kong.
37. The explanations given for electing Overboarding INEDs are set out in Chart 2 below.

¹⁰ Principle A.4 of the CG Code provides that there should be plans in place for orderly succession for appointments.

¹¹ The threshold is in line with the Institutional Shareholder Services' 2018 Benchmark Policy Recommendations for Hong Kong.

Chart 2: Reasons for believing that a director holding his seventh directorship (or more) is able to devote sufficient time to the board (CP A.5.5)¹²



Our comments

38. Good attendance record alone, the most commonly quoted reason, would not demonstrate why an Overboarding INED could still devote sufficient time to the board. INEDs are required, under the law¹³ and the Listing Rules, to be fully engaged with the issuer's affairs both inside and outside the boardroom.
39. Some issuers justified the appointment of an Overboarding INED by referencing the valuable contribution made by, and the extensive experience and skills of, the Overboarding INED. The reality is even the most capable individual would struggle to contribute if they lack the time.
40. A comprehensive disclosure would include details regarding the board's assessment of whether the individual can devote sufficient time for the issuer's affairs. A confirmation from the INED on time commitment cannot substitute the board's independent assessment. The Exchange has published guidance on factors that the nomination committee or the board should be aware of when considering an individual's time commitment¹⁴. A good disclosure would explain how the board, after *balancing* various factors, arrived at the conclusion that the director can devote sufficient time to the issuer's affairs.
41. The board's assessment could include an analysis of the following:
 - (a) the nature of the Overboarding INED's other directorships and/or significant appointments (e.g. executive or non-executive, full-time or part-time);
 - (b) any particular period that the Overboarding INED is likely to be occupied by his other appointments, and whether that prevents the Overboarding INED from devoting time to the issuer's affairs (e.g. overlapping of financial year-end or industry peak seasons);
 - (c) the Overboarding INED's involvement in boards and/or board committees (e.g. whether he is a chairman or not); and

¹² The percentages do not add up to 100% as most issuers referred to more than one reason in their explanations.

¹³ Companies Ordinance (Cap 622 Laws of Hong Kong, Part 10 Division 2 – Directors' Duty of Care, Skill and Diligence)

¹⁴ See HKEX, Guidance for Board and Directors, July 2018 at paragraph 2.17

- (d) ongoing measures adopted by the issuer to ensure that the Overboarding INED can carry out his duties despite his/her multiple directorships.

C. Board diversity, nomination and selection of directors

Board diversity policy

42. Principle A.3 of the CG Code provides that the board should have a diversity of perspectives appropriate to the requirements of the issuer's business. Diversity is an important driver of the board's effectiveness, creating different perspectives among directors and breaking down a tendency towards "group think".
43. The Listing Rules¹⁵ require all issuers to disclose a policy on board diversity in their corporate governance reports. The CG Code¹⁶ further requires such disclosure to include any measurable objectives that the issuer has set for implementing the policy, and progress on achieving those objectives.

Findings

44. Almost all Sample Issuers disclosed their board diversity policy. We are pleased to note that many issuers have considered board diversity from a wide range of aspects (e.g. gender, ethnic origin, age, professional background, experience and tenure with the issuer). We also observed the use of charts and diagrams to illustrate how diversity has been achieved, which facilitates readers' understanding of the board profile.
45. A small portion of Sample Issuers disclosed objectives for enhancing board diversity. Some issuers stated that they did not set any measurable objectives as their boards are sufficiently diverse.

Our comments

46. Whilst not mandatory under the Rules, setting measurable objectives facilitates issuers' progress evaluation and drives issuers' continuous scrutiny of their policies in achieving board diversity. Disclosure of such objectives further demonstrates the board's commitment to board diversity, allowing external stakeholders to track the company's progress in this area. As of 24 September 2020, 813 listed issuers have no female directors on their boards. These issuers should especially consider setting measurable objectives to work towards gender diversity on their boards.
47. In respect of listing applicants, since May 2019 they are required to disclose in the prospectus their board diversity policy, and for those with single gender board, how gender diversity of the board can be achieved (including measurable objectives set for implementing gender diversity)¹⁷. We 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 we will continue to monitor their progress.
48. Issuers may refer to "S.M.A.R.T." when setting objectives, which a commonly accepted approach designed to ensure that objectives set are specific, clear and attainable.

¹⁵ MB Rule 13.92 (GEM Rule 17.104)

¹⁶ MDR Section L(d)(ii).

¹⁷ HKEX-GL86-16 "Guide on Producing Simplified Listing Documents Relating to Equity Securities for New Applications".

Issuers may ask the following questions when setting S.M.A.R.T. objectives:

- (a) Specific – What specifically do you want to achieve?
 - (b) Measurable – How will you know when you have achieved the objective?
 - (c) Attainable – Is it something you have control over and can actually achieve?
 - (d) Relevant – How applicable is the objective to your business and does it align with existing strategies?
 - (e) Time bound – By when do you want to achieve your goal?
49. A high performance board is one that comprises directors whose combination of competencies and diversity of perspectives align with the issuers' strategy and objectives. Therefore, issuers are reminded to assess and review board diversity periodically in light of changes in the issuers' strategic direction, social circumstances or the environment in which issuers operate.

Nomination policy

50. Principle A.3 of the CG Code provides that the board should have a balance of skills, experience and diversity of perspectives appropriate to the issuer's business. Transparency on the issuer's nomination policy and process would enable the issuer to achieve the balance of skills, experience and diversity on board.
51. The CG Code¹⁸ requires all issuers to disclose their policy for the nomination of directors in their corporate governance reports, including the nomination procedures and the process and criteria adopted by the nomination committee or the board to select and recommend candidates for directorship during the year.

Findings

52. We are pleased to note that most issuers have made some form of disclosure on their nomination policy and procedures, as well as criteria considered by the nomination committee or the board to select and recommend a candidate for appointment.

Our comments

53. Appointments to the board should be subject to a formal, rigorous and transparent procedure to ensure a board composition with the necessary skills, experience and knowledge in alignment with the company's strategy, and to ensure plans are in place for orderly succession.
54. Disclosures regarding how potential candidates are identified would be useful for shareholders to fully appraise the whole nomination and appointment process.
55. Issuers should consider disclosing information on development of a diverse pipeline for succession (e.g. any programs implemented to prepare selected employees for senior management and board positions). The disclosures may also include the selection process within the pool of selected employees, such as how the selected candidates' experience and expertise align with the issuer's diversity needs. This demonstrates the

¹⁸ MDR Section L(d)(ii).

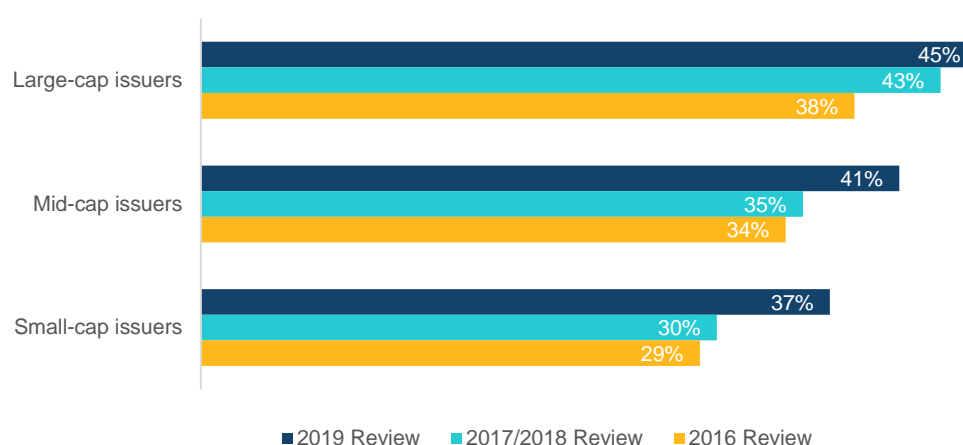
issuer's commitment to the board's diversity and succession planning, as well as the company's long-term development.

III. COMPLIANCE WITH THE CG CODE

A. Key statistics

56. We are pleased to note that all Sample Issuers have complied with at least 73 out of 78 CPs, and 41% of them have fully complied with all CPs (2017/2018 Review: 36%). The results indicate an improvement in issuers' compliance with the CG Code. Please refer to the Appendix for further statistics on Sample Issuers' compliance with the CPs.
57. Whilst Large-cap issuers achieved the highest rate of full compliance (i.e. compliance with all CPs), we are pleased to note that Mid-cap and Small-cap issuers were catching up. This signifies smaller companies' efforts in improving the corporate governance within their companies. Comparison with figures in previous reviews can be referred to Chart 3 below.

Chart 3: Full compliance by market capitalisation



58. We identified a number of common pitfalls regarding disclosures for MDRs during our review, details of which are set out in Section C below.

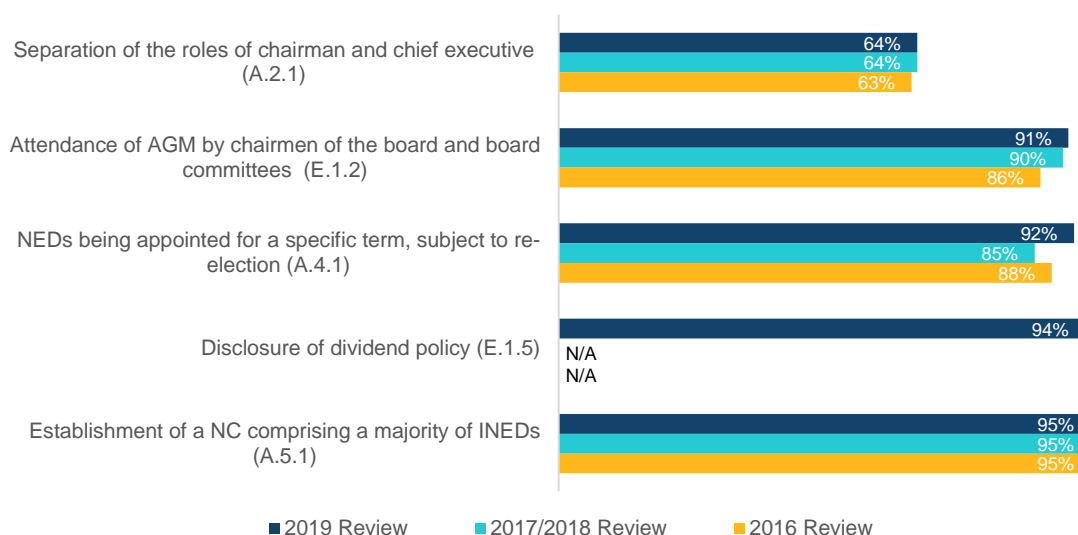
B. Five CPs with the lowest compliance rates and their reasons

59. In the 2019 Review, the Five Least Complied CPs were
- Separation of the roles of chairman and chief executive (CP A.2.1);
 - Attendance of AGM by chairmen of the board and board committees (CP E.1.2);
 - NEDs being appointed for a specific term, subject to re-election (CP A.4.1);
 - Disclosure of dividend policy (CP E.1.5); and
 - Establishment of a NC comprising a majority of INEDs (CP A.5.1).
60. Although separating the roles of chairman and chief executive remains a challenge for issuers (with a compliance rate of 64%), we are pleased to note that all the remaining CPs were complied with by a vast majority of the Sample Issuers (over 90%). Disclosure of dividend policy, with a compliance rate of 94%, is amongst the Five Least Complied CPs, most likely due to individual issuers' oversight of this recently introduced CP in

January 2019. Transparent and independent oversight by the NC regarding board nomination and recruitment, diversity and succession planning is key to promote better practice and standards. This is recognised by our issuers, and 95% of the Sample Issuers have already established a dedicated NC to oversee these matters.

61. Chart 4 below sets out the compliance rate of the Five Least Complied CPs in the 2019 Review, the 2017/2018 Review and the 2016 Review.

Chart 4: Compliance rate of the Five Least Complied CPs¹⁹



62. We examined the reasons given by Sample Issuers in respect of the Five Least Complied CPs, and set out our findings and comments below.

Separation of the roles of chairman and chief executive (CP A.2.1)

63. The chairman leads the board and is responsible for its overall effectiveness in directing the company, while the chief executive oversees the company’s operations. Principle A.2 of the CG Code provides that there should be a clear division of these responsibilities to ensure a balance of power and authority, so that power is not concentrated in any one individual.
64. CP A.2.1 provides that the roles of chairman and chief executive should be separate and should not be performed by the same individual. Having the roles assumed by two individuals can reduce the risk of power being concentrated in a particular individual.

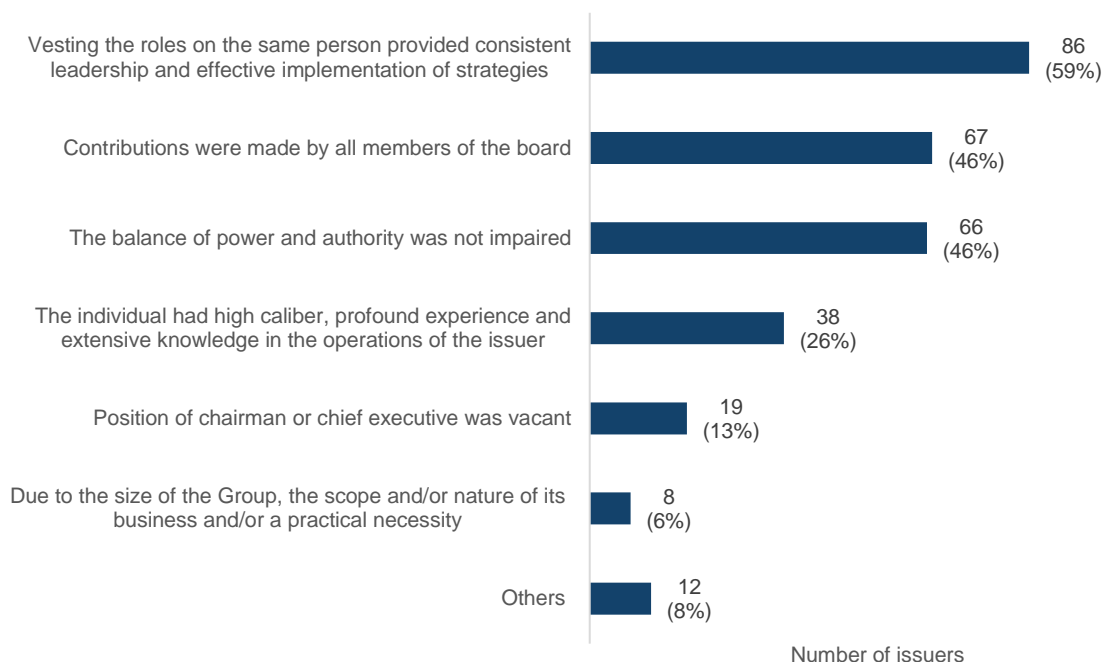
Findings

65. Chart 5 below summarises the main reasons given for not separating the roles²⁰:

¹⁹ Since CP E.1.5 was newly introduced in January 2019, there was no comparable figure in the 2017/2018 Review and 2016 Review.

²⁰ The percentages do not add up to 100% as most issuers referred to more than one reason in their explanations.

Chart 5: Reasons given for not separating the roles of chairman and chief executive (CP A.2.1)



66. Of the Sample Issuers which considered there to be no impairment to the balance of power (46%)²¹, many of them relied on grounds such as the existence of a competent board comprising experienced and high caliber members, and the availability of independent advice from INEDs. A few of these issuers made bare assertions without justification.

Our comments

67. Most issuers justified the non-compliance by stating the benefits of having the same individual to assume the two roles, such as ensuring consistent leadership and effective implementation of business strategies. Some issuers focused on the capability of such individual (e.g. high caliber, profound experience and extensive knowledge). Neither would demonstrate how the balance of power and authority could be ensured. The spirit of the CP is to avoid over-concentration of power on one individual, hence it is crucial for the company to address how the lack of separation of the roles is either overseen or addressed by alternative arrangements.

68. Some issuers relied on competence of board members, or that an adequate number of INEDs have been appointed to the board, to support the determination that balance of power was not impaired. A better practice would be explaining how the presence of these board members or INEDs effectively addresses the potential governance issue. For example, a discussion of the internal control framework that highlights the role of other board members or INEDs in scrutinising important decisions and/or monitoring the chairman cum chief executive's power.

69. Some issuers referred to the arrangements regarding their decision-making structure (e.g. important decisions require contributions by all board members or approval by an executive /management committee comprising members of the senior management) to

²¹ This figure dropped from that of the 2017/2018 Review (53%).

address the potential governance issues brought by the absence of separation. While this reduces the concentration of power in one individual, issuers may further discuss how the board monitors the exercise of power by the chairman cum chief executive.

- 70. It is understandable that a deviation from this CP may be temporary in nature due to resignation of the chairman or chief executive. In these cases, issuers should provide details on the interim measures put in place to safeguard the balance of powers, for example, a change in the approval and reporting framework that involves INEDs or other members of the senior management.

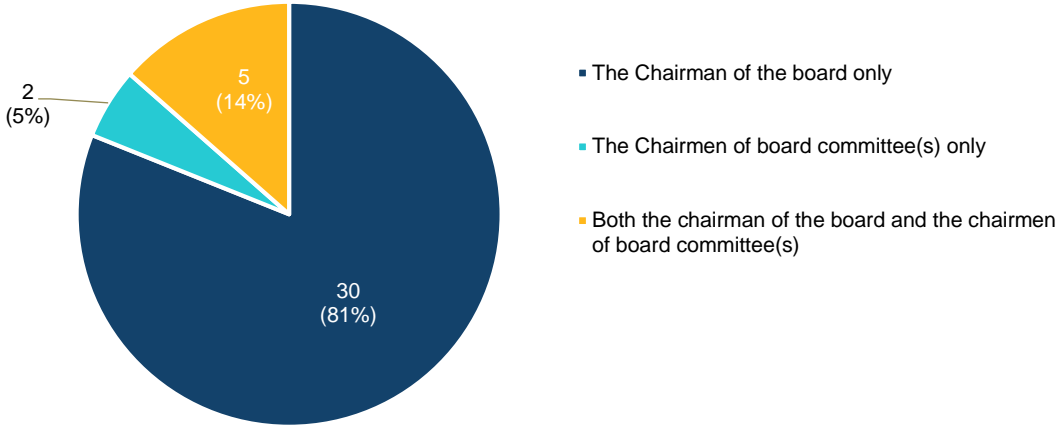
Attendance of AGM by chairmen of the board and board committees (CP E.1.2)

- 71. The AGM is an important means for the board to engage with its shareholders. CP E.1.2 provides that the chairman of the board should attend the AGM. The chairman should also invite the chairmen of the audit, remuneration, nomination and any other committees (as appropriate) to attend the AGM.
- 72. As the leader of the board, the chairman should attend the AGM to maintain a dialogue with the shareholders. It is also important for the chairmen of the audit, remuneration, nomination and any other board committees to attend the AGM and, where required, address any questions raised.

Findings

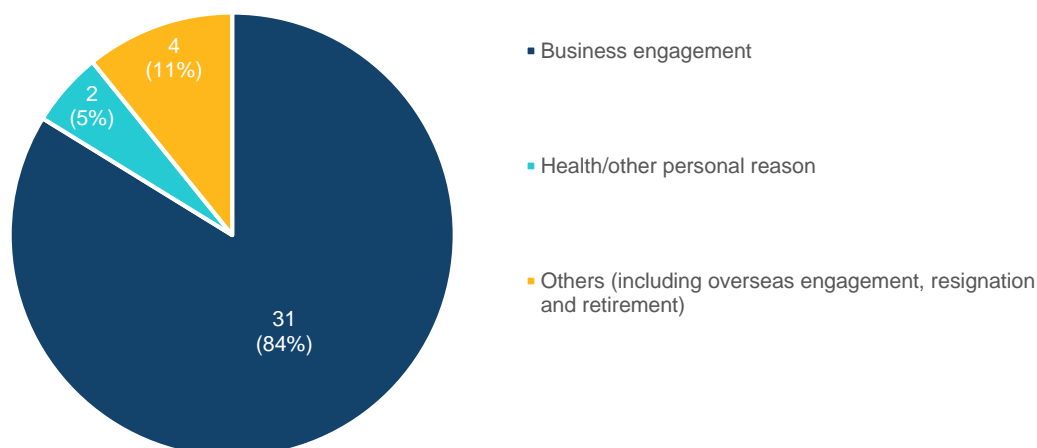
- 73. For most issuers who deviated from this CP, it was the chairman who was absent from the AGM. Please see Chart 6 below for a breakdown of parties absent from the AGM.

Chart 6: Breakdown of parties absent from AGM



74. Chart 7 below shows the reasons given by the issuers for the deviation from this CP:

Chart 7: Reasons for Chairmen's absence at AGMs



Our comments

75. Board should be responsible for maintaining an on-going dialogue with shareholders and in particular, use AGMs or other general meetings to communicate with them and encourage their participation. It is of utmost importance that the chairman of the board and/or the chairmen of board committee(s) attend AGMs to answer shareholders' questions, as well as receive constructive feedback on how the company is run. Unless there are exceptional circumstances, directors should prioritise AGM attendance.
76. Directors may participate in general meetings by electronic means (such as telephonic or video-conferencing facilities).²² The chairman of the board and/or the chairmen of board committee(s) should make use of electronic means to participate in AGMs if physical attendance is not feasible.

NEDs being appointed for a specific term, subject to re-election (CP A.4.1)

77. Principle A.4 of the CG Code provides that directors should be subject to re-election at regular intervals. CP A.4.1 requires that NEDs to be appointed for a specific term, subject to re-election.
78. NEDs may lose their independent edge if they remain on a board for too long. It is also essential to ensure the makeup of the board change in line with evolving business environment and challenges. Requiring specific term for NEDs and periodic re-elections gives shareholders a means to voice their support/ disapproval of the directors through the exercise of their voting power.

²² Subject always to the issuer's constitutional documents and the law and regulations of its place of incorporation. See note 1 to Section I of the CG Code.

Findings

79. Almost all issuers who deviated from this CP explained that the NED is subject to retirement by rotation²³ in accordance with their articles of association, by-laws or equivalent constitutional documents. This is consistent with our findings in previous reviews.

Our comments

80. Retirement by rotation is a measure required under another CP to limit a director's tenure²⁴. The two provisions ("appointment for a specific term" and "retirement by rotation") both require company to periodically seek shareholders' re-election of directors so as to prevent entrenchment. A comprehensive explanation for a deviation from CP A.4.1 should include a clear rationale for the alternative arrangement adopted by the issuer, and the impacts or outcomes of such arrangement.

Disclosure of dividend policy (CP E.1.5)

81. Dividend policy is a key factor for investors to assess an issuer's financial status, capital sufficiency and attitude to minority shareholders. Since 1 January 2019, a new CP E.1.5 has been introduced, providing that issuers should have a policy on payment of dividends and disclose it in the annual report.
82. This CP enables shareholders to make more informed investment decisions.

Findings

83. Some issuers have neither made the disclosure, nor explained why a dividend policy has not been adopted or disclosed.

Our comments

84. We believe that individual issuers may not be aware of this CP's introduction, and thus omitted to disclose a dividend policy or explain why they had not done so. Issuers are reminded that failure to disclose without any considered reasons amounts to a breach of the Listing Rules.
85. Issuers are recommended to include the following information in their CP E.1.5 disclosures:
- (a) The issuer's expected dividend pay-out ratio, significant distributions and material matters that should be drawn to investors' attention.
 - (b) Where future dividends are subject to discretion of the board, factors to be considered by the board.
86. Issuers choosing to deviate from this CP are also reminded that their explanations should set out the unique circumstances underlying to the decision not to adopt a dividend policy. Boilerplate language such as dependence on generic financial factors should be avoided.

²³ 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.

²⁴ CP A.4.2

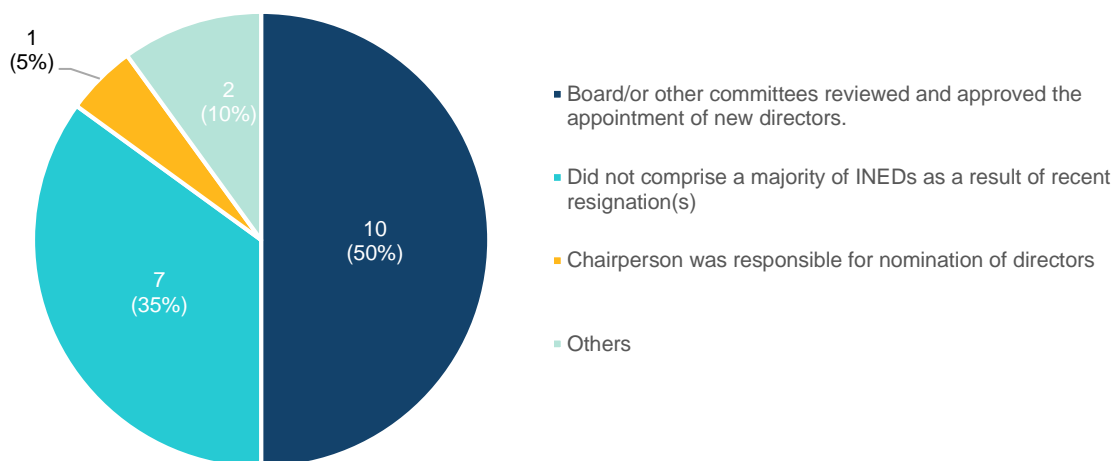
Establishment of a nomination committee comprising a majority of INEDs (CP A.5.1)

87. CP A.5.1 provides that issuers should establish a NC that is chaired by the chairman of the board or an INED and comprises of majority INEDs.
88. The aim is to ensure independent oversight of matters in relation to board recruitment, board diversity and succession planning.

Findings

89. There were two main categories of deviation from CP A.5.1:
- (a) No NC was established. About half the Sample Issuers deviated from this CP cited the reason that the board (or other board committees) had assumed the responsibility to review and approve the appointment of new directors and hence did not need a NC. In most of these cases, there was no explanation on why such arrangement was more desirable than establishing a NC.
- (b) NC did not comprise a majority of INEDs. About one third of the deviations were due to an INED's recent resignation from the board. As a result, the NC no longer comprised a majority of INEDs. In most of these cases, the deviation could not be rectified as the INED vacancy was not yet filled.
90. Chart 8 below shows reasons given for a deviation from CP A.5.1.

Chart 8: Explanations for a deviation from CP A.5.1



Our comments

91. In addition to stating the cause of the deviation (i.e. no NC was established or that an INED has resigned recently), explanations should include any measures taken to ensure that the spirit of the CP is adhered to. In particular:
- (a) Where no NC was established: Issuers are reminded that an effective board is one that comprises directors with a combination of competencies, skills and perspectives that align with the issuers' strategy and objectives. For the long-term development of a company, it is also crucial to plan for board succession,

such as having development plans for current board members and progression plans for those looking to move to board level.

Given the importance of having a high-performance board, issuers should ensure there is an oversight of matters relating to board recruitment, diversity and succession planning, and include the following disclosures in the CG report:

- Composition of the body that is responsible for the oversight
- Rationale for such arrangement (i.e. why is this more desirable than establishing a dedicated NC?)
- Discussion on how the responsible body implements the issuer’s policies on board nomination and board diversity (e.g. measures to ensure adequate consideration by such body of the independence and diversity of the board) and oversees board succession

(b) Where NC did not comprise a majority of INEDs: In addition to stating the reason for deviation (e.g. resignation of an INED), these issuers should also disclose measures taken to ensure the NC’s independence during the relevant period.

C. Common pitfalls

Omission or partial disclosure of MDRs

92. Certain MDRs were omitted by a relatively large proportion of issuers²⁵, possibly because those MDR(s) were not considered to be relevant or applicable to them. Issuers are reminded that information called for under the MDRs must be included in the CG report. Issuers should include a negative statement if they consider any of the MDRs not applicable to them for the relevant reporting year.
93. Some MDRs require disclosure on a number of different issues. Issuers are reminded to carefully go through each paragraph / sub-paragraph of the MDR to ensure that all required information are properly disclosed.

Commonly overlooked MDRs

94. The following MDRs are often overlooked or disclosed incorrectly:

MDR	Issue spotted
<u>Section L(d)(i), (ii) and (iii):</u> A summary of work during the year for the remuneration committee, the nomination committee and the audit committee	Disclosure setting out the committees’ functions, but omitted to include a summary of work performed by these committees during the year.
<u>Section L(d)(iii) and (v):</u> A summary of work during the year for corporate governance and for	Disclosure stating that the board (or a board committee) is responsible for corporate governance or risk management functions,

²⁵ For example, (i) up to 26% of Sample Issuers have omitted to disclose relationship (including financial, business, family or other material/relevant relationship(s)), if any, between board members and in particular, between the chairman and the chief executive (Section I(h)); and (ii) 16% of Sample Issuers were silent as to whether there were any significant changes to their constitutional documents during the year (Section P).

the risk committee (if any)	without any description on what the board (or the board committee) has done in these areas. While it is not mandatory to establish a corporate governance committee or a risk committee, the issuer should ensure that the board (or a board committee) oversees these functions, and include a work summary in the corporate governance report.
<u>Section I(i):</u> How each director, by name, complied with CP A.6.5	Disclosure confirming training has been provided to all directors, but omitted to disclose the training participated by each director <i>by name</i> .
<u>Section M:</u> An analysis of remuneration in respect of audit and non-audit services provided by auditors, including details of the nature of services and fees paid in respect of each significant non-audit service assignment	Disclosure on the monetary amount paid to auditors in respect of audit and non-audit services, but omitted to provide details of the nature of the underlying non-audit service assignments.
<u>Section Q(b):</u> How often the risk management and internal control systems are reviewed, the period covered, and where an issuer has not conducted a review during the year, an explanation why not	Disclosure confirming review on risk management and internal control systems conducted, but omitted to disclose the frequency of such reviews (e.g. quarterly, half-yearly or annually).

D. Voluntary disclosures

95. Notwithstanding the voluntary nature of recommended disclosures (“**RDs**”) and recommended best practices (“**RBP**s”), we are pleased to note that some Sample Issuers have gone the extra mile to disclose against some (if not all) RDs and RBPs for the benefit their readers. We would like to reiterate that the RDs and RBPs are practices that should be embedded in issuers’ behaviour for the issuers to achieve the objectives of the Principles set out in the CG Code. They are intended to stimulate the board’s thinking in how they can carry out their role most effectively to enhance the company’s corporate governance standards. While they may not be mandatory, adopting such practices demonstrates an issuer’s commitment to good corporate governance. We urge issuers to integrate these best practices into their corporate governance framework, and to make corresponding disclosure in their reports.

APPENDIX: STATISTICS ON CP COMPLIANCE

Table 1: Number of CPs disclosed by issuers as compliant

Number of CPs complied	2019 Review		2017/2018 Review	
	Number	Percentage	Number	Percentage
78	163	41%	144	36%
77	152	38%	144	36%
76	48	12%	67	17%
75	24	6%	20	5%
74	9	2%	11	3%
73	4	1%	5	1%
72	0	0%	5	1%
71	0	0%	2	0% ²⁶
70	0	0%	0	0%
<70	0	0%	2	0%
Total	400	100	400	100%²⁷

Table 2: Compliance rate with each CP

	2019	2017/2018
Code Provision	% of compliance	% of compliance
A. DIRECTORS		
A.1 The Board		
A.1.1	98%	98%
A.1.2	100%	100%
A.1.3	99%	100%
A.1.4	100%	100%
A.1.5	100%	100%
A.1.6	100%	100%
A.1.7	100%	100%
A.1.8	99%	98%
A.2 Chairman and Chief Executive		
A.2.1	64%	64%
A.2.2	100%	100%
A.2.3	100%	100%
A.2.4	100%	100%
A.2.5	100%	99%
A.2.6	100%	100%
A.2.7	97%	95%
A.2.8	100%	100%

²⁶ 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%.

²⁷ The total percentage does not amount to 100% due to rounding.

	2019	2017/2018
Code Provision	% of compliance	% of compliance
A.2.9	100%	100%
A.3 Board composition		
A.3.1	99%	100%
A.3.2	100%	100%
A.4 Appointments, re-election and removal		
A.4.1	92%	85%
A.4.2	97%	96%
A.4.3	100%	100%
A.5 Nomination Committee		
A.5.1	95%	95%
A.5.2	99%	96%
A.5.3	100%	96%
A.5.4	100%	96%
A.5.5	100%	100%
A.5.6	N/A	100%
A.6 Responsibilities of directors		
A.6.1	100%	100%
A.6.2	100%	100%
A.6.3	100%	100%
A.6.4	100%	100%
A.6.5	99%	100%
A.6.6	100%	100%
A.6.7	96%	85%
A.6.8	100%	100%
A.7 Supply of and access to information		
A.7.1	100%	100%
A.7.2	100%	100%
A.7.3	100%	100%
B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT AND BOARD EVALUATION		
B.1 The level and make-up of remuneration and disclosure		
B.1.1	100%	100%
B.1.2	98%	100%
B.1.3	100%	100%
B.1.4	98%	100%
B.1.5	100%	100%

	2019	2017/2018
Code Provision	% of compliance	% of compliance
C. ACCOUNTABILITY AND AUDIT		
C.1 Financial reporting		
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 Risk management and internal control		
C.2.1	99%	100%
C.2.2	100%	100%
C.2.3	100%	100%
C.2.4	100%	100%
C.2.5	99%	99%
C.3 Audit Committee		
C.3.1	100%	100%
C.3.2	100%	100%
C.3.3	99%	100%
C.3.4	100%	100%
C.3.5	100%	100%
C.3.6	100%	100%
C.3.7	99%	100%
D. DELEGATION BY THE BOARD		
D.1 Management functions		
D.1.1	100%	100%
D.1.2	100%	100%
D.1.3	100%	100%
D.1.4	97%	99%
D.2 Board Committee		
D.2.1	100%	100%
D.2.2	100%	100%
D.3 Corporate Governance Functions		
D.3.1	100%	100%
D.3.2	100%	100%
E. COMMUNICATION WITH SHAREHOLDERS		
E.1 Effective communication		
E.1.1	100%	100%
E.1.2	91%	90%

	2019	2017/2018
Code Provision	% of compliance	% of compliance
E.1.3	100%	100%
E.1.4	100%	100%
E.1.5	94%	N/A
E.2 Voting by Poll		
E.2.1	100%	100%
F. COMPANY SECRETARY		
F.1.1	100%	100%
F.1.2	99%	100%
F.1.3	99%	100%
F.1.4	100%	100%

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