# Guidance for Boards and Directors

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1. **INTRODUCTION**

1.1 An important role of The Stock Exchange of Hong Kong Limited (the "Exchange") is to promote good corporate governance amongst issuers, and at the centre of good governance is an effective board. The long term success of the issuer is dependent on a quality board on which the directors are competent, well-qualified, committed with diverse backgrounds and independence of mind and perspectives.

1.2 The governance framework embodied in the Corporate Governance Code and Corporate Governance Report (the "Code") and the Exchange Listing Rules (the "Rules") is designed to help boards to be effective, by providing benchmarks and best practice guidance for the delivery of good corporate governance.

1.3 Achieving high standards of corporate governance requires continuous effort from all concerned and improving the quality of our directors continues to be the Exchange's focus. We launched the director training webcast series in early 2017 aimed at providing practical training to directors. Topics of the webcasts\(^1\) included duties of directors and role and function of board committees, risk management and internal control, environmental, social and governance, IPOs, as well as roles of the company secretary. The webcasts combine key regulatory messages with real-life examples, presented by company directors and market practitioners.

1.4 In November 2017, the Exchange consulted on reviewing the Corporate Governance Code and related Listing Rules ("CG Consultation").\(^2\) The main areas of the review included overboarding and independent non-executive director's time commitment, board diversity, factors affecting the independence of independent non-executive directors, role of nomination committee among other corporate governance issues. The Consultation Conclusions paper was published on 27 July 2018.

1.5 This Guidance has taken into consideration the feedback to the CG Consultation including calls for guidance in specific areas, and aims to provide practical advice to board and directors, and in some cases, set out the expectations placed on directors. However, the Guidance does not form a part of the Listing Rules, nor do they amend or vary any Rule requirements, or absolve issuers and/or their directors of any obligations to make their own judgment. The Guidance covers the following areas:

- Directors' Duties and Board Effectiveness;
- Board Committees' Role and Functions;
- Board Diversity and Policy;
- Risk Management and Internal Control;
- Company Secretary; and
- Corporate Governance for weighted voting rights ("WVR") issuers.\(^3\)

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\(^3\) Following the publication of the Consultation Conclusions on the New Board Concept Paper in December 2017, the Exchange published a Consultation Conclusions on "A Listing Regime for Companies from Emerging and Innovative Sectors" which introduced the framework for Weighted Voting Rights.
2. DIRECTORS’ DUTIES AND BOARD EFFECTIVENESS

2.1 The board’s responsibility includes:

- leading, directing and supervising the issuer’s affairs to enable the long-term success of the issuer;
- setting strategic objectives with appropriate focus on value creation and risk management;
- ensuring transparency, i.e. adequate and comparable reporting in annual reports including financial statements, corporate governance and environmental, social and governance ("ESG"), disclosures of the board’s practice (e.g. terms of references of its board committees), policies (e.g. shareholder communication, remuneration, nomination, dividend and diversity policies);
- being accountable – it means that directors be held accountable for their actions or inactions, and where appropriate, take the shareholders’ and stakeholders’ views into account in their decisions; and
- ensuring adequacy of resources, staff qualifications and experience, especially for issuer’s accounting, internal audit and financial reporting function.

All Directors

2.2 Directors, whether they are executive directors ("EDs"), non-executive directors ("NEDs") or independent non-executive directors ("INEDs") they are subject to the same legal duty\(^4\) under the law and the Listing Rules. They must, in the performance of their duties as directors, act honestly and in good faith in the interests of the issuer as a whole and avoid actual and potential conflicts of interest and duty. Nevertheless dependent on whether they are EDs, NEDs or INEDs, they have different roles and functions, and the manner in which the duty should be discharged may potentially be different.

2.3 Before accepting the role, a potential director should devote time to understand the issuer by participating in initiatives such as visiting operations and speaking to senior and middle management and non-managerial members of the workforce, looking at some of the major projects, understanding the strategies and the competitive environment of the issuer. The potential director should use these initiatives to ensure that once they take on the role, they will immediately be able to make value-added contributions to the board, particularly on providing advice on the strategies of the issuer.

2.4 When a director joins the board, there should be an induction training programme for the new director. It is the responsibilities of all directors to ensure that they keep abreast with the latest developments in areas, including laws and regulations, the Rules as well as industry-specific and innovative changes to enable them to discharge their duties and responsibilities for the benefit of the issuer. Issuers should provide training programmes tailored to meet each director’s needs at its expense.

2.5 All directors need to appreciate that although they are directors, they cannot be and are not expected to be a subject expert in all matters. They should nevertheless have a thorough understanding of the issues being discussed at board meetings so as to enable them to contribute to discussions and

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\(^4\) Section 465 of the Companies Ordinance (Cap.622).
discharge their responsibilities.

2.6 Directors are entitled to seek further information / documentation from the management on matters to be discussed at board meeting. Where they have difficulties understanding a transaction, they can seek help from the issuer’s company secretary or external professional advisors at the issuer’s expense (lawyers, accountants or financial advisors). However, they are expected to carry out sufficient due diligence and not rely solely on professional advisers or valuers or other experts.

2.7 It is both the directors’ and the management’s responsibilities to ensure the board is getting the right level of information in order for directors to gain a good understanding of the transactions or issues at hand. In addition, management should provide directors with a summary of the documents to help them identify any potential issues quickly. Examples of information provided by the management can include:

- board papers;
- background information;
- disclosure documents;
- budgets for specific projects;
- forecasts; and
- monthly financial updates.

2.8 Directors must understand that when faced with disciplinary proceedings for failing to discharge their duties and responsibilities, it is not a defence to claim that they did not receive adequate information from the issuer or that they did not understand the relevant transactions. For disciplinary proceedings, depending on the relevant facts and circumstances of a particular case, the level of culpability of different directors could potentially vary and, accordingly, the sanctions and penalties.

EDs

2.9 EDs are involved in the day-to-day operations of the businesses. Being members of the issuer’s senior management, EDs should ensure that the management is accountable to the board, and ultimately to the shareholders. They should demonstrate willingness to listen to, and work closely with NEDs and INEDs.

NEDs and INEDs

2.10 NEDs are not part of the issuer’s management and are not considered independent. INEDs are independent directors fulfilling the independence criteria under the Listing Rules. Both NEDs and INEDs are expected to keep up to date with the issuer’s business affairs and contribute to the board’s strategic objective setting. They should be involved in scrutinizing the issuer’s performance in achieving agreed corporate goals and objectives, and monitor performance reporting.

2.11 Some INEDs were appointed to new listing applicants late in the listing process which means they may not have had sufficient time to gain a proper understanding of the applicant’s affairs, and their responsibilities as directors.
of a listed company before the company is listed. A new listing applicant is recommended to appoint INEDs at least two months prior to listing.

2.12 They are also expected to:

- bring an independent judgment to bear on issues of strategy, policy, performance, accountability, resources, key appointments and standards of conduct;
- take the lead where potential conflicts of interests arise;
- serve on the audit, remuneration, nomination and other governance committees, if invited; and
- make effective contribution at board meetings.

2.13 INEDs add value to the board by providing a fresh pair of lens that help to scrutinize some of the board's major decisions. INEDs may not be industry practitioners or experts in the business, but they may have other skills and experience in areas such as legal, accounting, real estate, IT or others which help to enhance the board’s balance of skills, experience and diversity of perspectives.

**INED’s Time Commitment**

2.14 It is crucially important that INEDs make sufficient time available to discharge their responsibilities and should not accept an invitation to serve as an INED on an issuer’s board unless they can devote adequate time and effort to the work involved.

2.15 In recent years, both statutes\(^5\) and the Listing Rules have been strengthened on directors’ duties which make it essential that the INEDs should be fully engaged with the issuer’s affairs both inside and outside the boardroom.

2.16 From financial period starting 1 January 2019, it is a “comply or explain” requirement that issuers should explain that the proposed INED would be able to devote sufficient time to the board if the person will be holding their seventh (or more) listed issuer directorship. INEDs sitting on multiple boards will need to ensure that they devote sufficient time to each board and board committees.

2.17 The nomination committee or the board (if the issuer does not have a nomination committee) should be aware of factors which can affect an individual’s time commitment to the issuer, such as:

- directorship at a listed issuer undergoing a period of particularly increased activity, such as an acquisition or takeover;
- chairing a listed issuer’s board and/or board committees;
- members of board committees;
- a CEO or full time executive director at another listed issuer; and
- an INED for multiple boards and a number of significant commitments at government or non-profit making bodies.

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\(^5\) Companies Ordinance (Cap 622 Laws of Hong Kong, Part 10 Division 2 – Directors’ Duty of Care, Skill and Diligence).
3. BOARD COMMITTEES’ ROLE AND FUNCTIONS

3.1 The board is responsible for performing the corporate governance duties but it is permitted to delegate the responsibility to board committees.

3.2 The core committees of the board are nomination, audit and remuneration committees. There are increasing expectations on these committees to advise the board and carry out the board’s corporate governance responsibilities. The chair of the audit and remuneration committees must be an INED. A nomination committee can be chaired by the chairman of the board or an INED. A majority of their members must or should be INEDs to allow strong representation of INEDs on these committees.

3.3 The chair of the board and each of the board committees is expected to be present and address shareholders’ queries at general meetings. The issuer should explain with genuine and good reasons when the chair of the board or board committees failed to attend annual general meetings.

Nomination Committee

3.4 The nomination committee’s key role is board recruitment. It must evaluate and assess the optimal composition of the board, taking into account the issuer’s agreed strategies and objectives. For instance, many issuers say they would like to develop innovative technology, but there may be no one on the board who has the expertise. The nomination committee looks at particularly the skills that are available as a board, and see whether those are appropriate for the current situation that the business is in, some of the challenges it might be facing, and some of the opportunities that it might wish to exploit.

3.5 There should be an established policy on how to identify potential directors. The selection process should be transparent and fair. Issuers are encouraged to select from a broad range of candidates who are outside the Board’s circle of contacts, and in accordance with the issuer’s diversity policy.

3.6 Developing a list of desirable skills, perspectives and experience at the outset of the selection process for a new director is a good way to focus the search effort. This will ensure that the new comer’s contribution to the board will be valuable.

3.7 The nomination committee should not only meet when there are board appointments to be considered, they should also meet to consider the performance of the board. They may look at benchmarking how the issuer’s board measures up against the other boards in Hong Kong of peer issuers.

3.8 The nomination committee should be mindful of the need to refresh the board regularly to avoid entrenchment and to attract fresh thinking. It must also consider succession planning to ensure the long term success of the issuer.
Nomination Policy

3.9 In formulating their nomination policies, issuers are encouraged to consider the following guidance:

- state the objectives of the nomination policy. This should include ensuring the board has a balance of skills, experience and diversity of perspectives appropriate to the requirements of the issuer’s business;

- emphasise the ultimate responsibility for selection and appointment of directors rests with the entire board;

- set out the procedure for the selection, appointment and reappointment of directors containing the selection criteria. This should include, but not limited to, considering the potential contributions a candidate can bring to the board in terms of qualifications, skills, experience, independence and gender diversity;

- board succession planning considerations and periodical reviews of the plan;

- the way in which the issuer will disclose its nomination policy and how the progress made towards achieving the objectives set in the policy is disclosed periodically (e.g. in the corporate governance report); and

- a formal process for monitoring and reviewing the nomination policy to ensure that it remains relevant to the issuer’s needs and reflects both current regulatory requirements and good corporate governance practice.

Audit Committee

3.10 The audit committee has the important functions of monitoring the integrity of the issuer’s financial statements, annual and interim reports and account, risk management and internal control as well as maintaining an appropriate relationship with the issuer’s external auditors. The audit committee should stay focused on financial reporting integrity as part of its core oversight responsibilities.

3.11 It is also charged with the responsibility to ensure that the internal audit function is adequately resourced and has appropriate standing within the issuers, and to review and monitor its effectiveness. Adequately resourced means that the function is staffed by people with appropriate qualification, experience, integrity and independence of mind.

3.12 The audit committee should have full cooperation of the management and be supplied with sufficient information and reasonable resources to carry out its role and function in accordance with its terms of reference. The audit committee must take an active interest and be proactive in understanding the affairs of the issuer and investigate where there are red flags. Management should liaise with the audit committee and ensure that they hold thorough discussions with the auditors at least twice a year. They should also explain the judgments of key assumptions underlying critical accounting estimates. This is because each judgment or estimate can significantly impact the key balances in an issuer’s financial statements.

3.13 The role of external auditors is important to ensure the integrity of issuer’s financial reporting and where the board disagrees with the audit committee’s
views on the selection, appointment, resignation or dismissal of the external auditors, the Code requires the issuer to explain this disagreement in the corporate governance report.

3.14 The independence of external auditors should be reviewed by the audit committee annually. For instance where an external auditor also provides non-audit services, the audit committee should consider:

- the nature of the non-audit service;
- whether there are safeguards in place to ensure that there is no threat to the objectivity and independence of the audit;
- the aggregate fees paid to the external auditors and a breakdown of the fees paid for audit and non-audit services for the financial year.

3.15 The audit committee should also monitor management’s progress on implementing any new key financial reporting standards, and stay updated with tax legislature and regulatory developments in relation to financial reporting.

Remuneration Committee

3.16 The main role of the remuneration committee is to assist and advise the board on the remuneration of the board and senior management. In so doing, the remuneration committee should have formulated strategy and policy remuneration on all directors, as well as a set of formal and transparent procedure to implement the policy. The aim is to motivate, retain and attract the best talents for the issuer, so as to maximise shareholder value.

3.17 The remuneration committee should consider all aspects of remuneration including:

- salaries paid by comparable issuers, time commitment and responsibilities, employment conditions in the group;
- appointment and termination terms for directors and senior management to ensure they are fair; and
- compensation arrangements relating to dismissal or removal of directors for misconduct to ensure they are reasonable and appropriate.

3.18 If the board resolves to approve any remuneration or compensation arrangements with which the remuneration committee disagrees, the board is encouraged to disclose the reasons for its resolution in the next corporate governance report.
4. BOARD DIVERSITY AND POLICY

Board Diversity

4.1 A high performance board is one that composes directors with the combination of competencies and diversity of perspectives aligning with the issuer’s strategy and objectives, and which is in the best position to deal with the key issues that the issuer faces.

4.2 Recent years have seen a growing focus on board diversity. It is believed that greater diversity of directors is good for corporate governance because it promotes board effectiveness and enables better decisions to be made due to the lessened risk of groupthink.

4.3 When nominating a director, the board, assisted by the nomination committee, should consider the skills, experience and diversity of perspectives that the nominee is expected to bring to the board and what are the nominee’s potential contributions. The board’s consideration and rationale in this area should be explained clearly in the circular to shareholders accompanying the resolution to elect the directors.

4.4 Board diversity is also increasingly important as a factor for investors when making investment decisions and which is an area that our market cannot afford to ignore.6

Gender Diversity

4.5 Diversity encompasses more than simply gender but gender diversity is particularly important to many stakeholders and statistics on gender diversity can be obtained with more certainty than other factors such as cultural, educational background and professional experience, etc.

4.6 A growing number of studies have shown that gender and other aspects of diversity enables the board to better able to understand their customers’ and stakeholders’ needs and is positively associated with the issuer’s financial performance, more effective board and better risk management. Hong Kong appears to be lagging behind other leading markets in terms of the ratio of women on boards and fall below the average growth according to some research statistics.7

4.7 A substantial proportion of our issuers are without a single woman on their boards.8 There should be more transparency on the considerations for diversity, including gender, during the nomination process of directors. The diversity policy and the progress made towards meeting the measurable objective in the policy must be disclosed in the corporate governance report.

Diversity Policy

4.8 The Listing Rules require every issuer to have a diversity policy and disclose the policy or a summary of it in the corporate governance report. It is important to note that a diversity policy should include measurable objectives that the issuer has set for implementing the diversity policy (for example, those relating to gender), and progress on achieving those objectives.

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8 Approximately one third of all issuers do not have a woman on their boards.
4.9 Issuers should formulate their diversity policies in accordance with their own circumstances. They are encouraged to consider the following guidance:

- articulate the benefits of diversity, including gender diversity, and the importance of being able to attract, retain and motivate employees from the widest possible pool of available talent;

- express the issuer’s commitment to diversity at all levels, including gender, age, cultural and educational background, or professional experience;

- assess annually on each issuer’s diversity profile including gender balance of the directors and senior management and their direct reports, and its progress in achieving its diversity objectives;

- ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered; and

- state whether the issuer has identified and implemented programs that will assist in the development of a broader and more diverse pool of skilled and experienced employees and that, in time, their skills will prepare them for senior management and board positions.

Board Skills Matrix

4.10 A board skills matrix is a table that displays the board members’ proficiency in specified skills, experience and diversity of perspectives. It helps the board to assess the current mix of competencies and diversity on the board and identify any gaps that may exist.

4.11 A board skills matrix will show the directors’ attributes and competencies and how they contribute to the issuer’s strategic direction and succession planning as well as diversity. Disclosing such a matrix is good practice and will be appreciated by investors as it demonstrates a transparent process for board’s selection and appointment of directors.

4.12 We appreciate that the strategy and objectives of each board is different and so are the criteria in a board skills matrix. Whilst it is not possible to have a “one size fits all” list of criteria, would typically include: industry or professional knowledge and experience, gender, technical skills and management experience, etc.
5. **RISK MANAGEMENT AND INTERNAL CONTROL**

**Why Should Issuers Focus on Risk Management?**

5.1 An effective risk management and internal control system not only ensures regulatory compliance, it is also a business imperative. Numerous research and studies indicate that companies with better risk management practices outperform their peers financially.

**Board’s Role**

5.2 Risk identification and control is the board’s responsibility. When the board discusses the issuer’s long term strategic objectives, it should at the same time deal with internal control issues including the issuer’s risk appetite, risk and return trade-offs, risk management and internal control systems.

5.3 The board should lead in shaping and developing the issuer’s risk culture, setting the tone at the top.

**Management’s Role**

5.4 Management is responsible for carrying out and implementing the board’s risk management policy and procedures. It should design, implement and monitor the risk management and internal control systems and confirm to the board on the effectiveness of the systems.

**Risk Management Policy and Procedures**

5.5 There should be a formally documented risk management policy and procedures in place which should be endorsed by senior management and the board.

5.6 There should be an audit plan which reviews the internal control systems that deal with the identified risks.

5.7 Testing of the systems’ effectiveness is essential which should include performing walkthroughs for notifiable and connected transactions to understand and document the process flow of transactions and the controls management has put in place, the strength of their design, the completeness of the process, and any controls that prevent or detect fraud and errors.

5.8 Based on findings of the previous steps, fix any identified weaknesses within the timeline specified.

**Risk Identification**

5.9 Different issuers face different risks, dependent on the scale, complexity and geographical locations of their business operations. However, in order to help issuers to better understand the possible steps to take to identify risks, we set out some suggestions below:

- Analyse the source of potential internal and external risks that can arise in relation to the issuer’s business. For example, cyber security or labour risks;
- prioritise the potential risks through discussions within the issuer’s management;
create a risk register which is populated with key strategic risks, i.e. risks that might prevent the issuer from achieving its strategic objectives. The risk register should be a record of all the risks of the issuer face and it should be reviewed and updated regularly, at least annually; and

plot the risks into a matrix in the form of a “heat map”. In the “heat map”, there should be a list of the issuer’s top 10 to 20 risks based on which the board can consider and review the internal control systems to mitigate them.

Appropriate Approach to Risks

5.10 Doing business always involves risks. There needs to be a right balance between excessive focus on eliminating risks and paying insufficient attention to risks. The latter includes treating risk management merely as a compliance issue.

5.11 Make adequate disclosures on the board’s annual review of the issuer’s risk management and internal control in the corporate governance report.
6. COMPANY SECRETARY

Selecting the Company Secretary

6.1 When selecting a company secretary, the issuer should consider whether the candidate is of the right calibre and of sufficient seniority for the issuer, given its size and complexity of operations.

Role and Function

6.2 Company secretaries have been regarded as key advisers on corporate governance and other regulatory compliance matters. They must keep up-to-date with regulatory and legal developments relevant to the issuers that they serve. They may do so through continuous training and professional development. To discharge their duties, they should:

- help the issuer construct and maintain a sound and effective corporate governance framework and in particular, a set of risk management and internal control systems to ensure regulatory compliance;

- be aware of developments in laws, rules and regulations that may affect the issuers’ business and operation;

- be pro-active and think about issues that may arise and provide advice to the Board in accordance with the laws, rules and regulations;

- ensure that the board receive continuous training on regulatory developments that are relevant to their business developments and needs; and

- provide compliance advice to the board and senior management in the decision-making process.

6.3 Company secretaries have been regarded as a crucial conduit of communications between:

- the board and the management: on the one hand, the company secretary updates the chief executive officer and the board (including the independent non-executive directors) on the information provided by the senior management and on the other hand, the company secretary conveys the board’s decisions to the senior management;

- the issuer and its shareholders: the company secretary ensures a good channel of communication through email or in the annual general meeting; and

- the issuer and regulators such as the Exchange: when the issuer receives enquiries from a regulator, the company secretary should work with the board and senior management and assist in responding to the regulator in a timely manner.
External Service Provider

6.4 If the board is relying on an outsourced professional or external service provider as company secretary, it must ensure that such outsourced professional or external service provider has the resources to follow closely with the issuer’s daily affairs, such that it can perform its duties properly.

6.5 The issuers that engage external service providers as company secretaries should consider the following factors and take appropriate steps to mitigate the potential issues associated with these factors:

- the external service provider may not have day-to-day knowledge of the issuer’s affairs;

- there may be time gaps in communication particularly those that may be time sensitive, e.g. the Exchange’ enquiries to the issuer on potentially price sensitive market rumours; and

- some external service providers may be acting as company secretaries of a large number of listed issuers. Issuers may need to consider whether external service providers would be able to devote sufficient time to the issuer’s affairs.

6.6 When appointing an external service provider as a company secretary, the issuer should designate a senior executive as a contact person within the issuer who will work closely with the external service provider.

6.7 For more guidance on company secretary’s role and functions, and in particular where an external service provider is engaged as a company secretary of a listed issuers, please refer to the Hong Kong Institute of Chartered Secretary’s “Company Secretary Appointment Guidelines for HKICS Members – Good Practice as to the Number of Appointments as ‘Named’ Company Secretaries of Hong Kong Listed Issuers”\(^9\).

\(^9\) Accessible at: [https://www.hkics.org.hk/media/publication/attachment/PUBLICATION_A_2411_Company_Secretary_Appointment_Guidelines_for_HKICS%20Members.pdf](https://www.hkics.org.hk/media/publication/attachment/PUBLICATION_A_2411_Company_Secretary_Appointment_Guidelines_for_HKICS%20Members.pdf)
7. CORPORATE GOVERNANCE OF WVR ISSUERS

7.1 Issuers with a WVR structure are required to comply with additional regulatory requirements and safeguards set out in Chapter 8A of the Listing Rules.

7.2 Additional areas include:

- right of Non-WVR Shareholders\(^{10}\) to convene an extraordinary general meeting;
- resolutions requiring voting on a one vote per share basis;
- establishment of a nomination committee;
- INEDs are subject to retirement by rotation at least once every three years;
- establishment of a Corporate Governance Committee;
- additional reporting requirements (including summary of the work of the Corporate Governance Committee);
- requirement to appoint a Compliance Adviser;
- compliance with “Communication with Shareholders” of Appendix 14 of the Listing Rules; and
- Compulsory training for directors, senior management and company secretary.

7.3 Issuer with a WVR structure is a relatively new concept\(^{11}\). We will monitor the market development in this area and may publish further guidance to boards and directors of WVR Issuers.

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\(^{10}\) A shareholder of a class of listed shares of an issuer with a WVR structure who is not also a beneficiary of weighted voting rights.

\(^{11}\) See footnote 3.