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WING HANG BANK, LTD.

18 March, 2011

Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

**By hand & by fax (2524-0149)**

**Re: Consultation Paper on Review of the Code on Corporate Governance Practices and Associated Listing Rules**

Dear Sir/Madam,

We welcome the opportunity to provide feedback on the captioned Consultation Paper. We respectfully submit this letter to comment on in particular the proposal to upgrade the recommendation that shareholders vote on a separate resolution to retain a director who has served on a board for more than nine years from Recommended Best Practice (RBP)A.4.3 to a Code Provision (CP)(re-numbered CP A.4.3). We respectfully submit that there is no need to upgrade RBP A.4.3 (shareholders to vote on a separate resolution for the further employment of an INED who has served more than nine years) to a CP (re-numbered CP A.4.3). We set out below the reasons for our view.

The 9-year rule is arbitrary and not supported by empirical evidence

Whether in Hong Kong or other jurisdictions, there is no empirical evidence to support a link between the length of tenure of a director and his or her level of independence. In fact, our understanding is that it was perhaps one of the most contentious suggestions of the U.K. Combined Code on Corporate Governance that an independence issue can arise just because a director has served on the board for nine or more years.

In any event the 9-year period is arbitrary. The 9-year period appears to be merely based on a director having served three 3-year terms consecutively. It is necessarily a matter of subjective judgement whether the length of term served has impaired a director's independence. One company may consider *x* years' service has so impaired a director's judgement, while another company may not. The two companies could even be referring to the same length of service of the same director but on their respective boards. Even if assuming that the length of tenure may impair a director's independence, it is difficult to nail down an optimum years of service that could apply to every board. In fact, an optimum tenure presumes that up to that time, board members add value and enhance performance, but beyond that period, their value contribution declines. This is frequently not the case. In reality, the answer to this question is likely to vary according to the leadership, culture, history, business



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situation, board dynamics, and board talent needs of the board in question. There is no evidence that nine years represents a meaningful milestone.

Independence is a mind-set and affected by other more significant factors

Independence is more of a "mind-set" and not influenced by the number of years spent on the board. Equally, it is possible for a director who has served on a board only a short time not to be independent. The proposed 9-year rule does not take into consideration the fact that a board member's effectiveness does not necessarily correlate with the length of board service. The nine-year rule is particularly unsuitable because there are many other factors which are more significant than length of service that may influence a director's independence but none of these other more significant factors are subject to the separate and additional requirement of shareholders vote on a separate resolution for the retention of a director who is affected. In this connection, it is relevant to note that in assessing the independence of a non-executive director, the Hong Kong Stock Exchange takes into account the factors as set out in Rule 3.13 of the Listing Rules. Rule 3.13 states that independence is more likely to be questioned if the director:

*(1) holds more than 1% of the total issued share capital of the listed issuer;*

*(2) has received an interest in any securities of the listed issuer as a gift, or by means of other financial assistance, from a connected person or the listed issuer itself.;*

*(3) is a director, partner or principal of a professional adviser which currently provides or has within one year immediately prior to the date of his proposed appointment provided services, or is an employee of such professional adviser who is or has been involved in providing such services during the same period, to:*
*(a) the listed issuer, its holding company or any of their respective subsidiaries or connected persons; or*
*(b) any person who was a controlling shareholder or, where there was no controlling shareholder, any person who was the chief executive or a director (other than an independent non-executive director), of the listed issuer within one year immediately prior to the date of the proposed appointment, or any of their associates;*

*(4) has a material interest in any principal business activity of or is involved in any material business dealings with the listed issuer, its holding company or their respective subsidiaries or with any connected persons of the listed issuer;*

*(5) is on the board specifically to protect the interests of an entity whose interests are not the same as those of the shareholders as a whole;*

*(6) is or was connected with a director, the chief executive or a substantial shareholder of the listed issuer within two years immediately prior to the date of his proposed appointment;*


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*(7) is, or has at any time during the two years immediately prior to the date of his proposed appointment been, an executive or director (other than an independent non-executive director) of the listed issuer, of its holding company or of any of their respective subsidiaries or of any connected persons of the listed issuer;*

*(8) is financially dependent on the listed issuer, its holding company or any of their respective subsidiaries or connected persons of the listed issuer.*

It is noteworthy that a director's length of tenure is not included in the list as one of the factors that may impair a director's independence. Although the factors set out in Rule 3.13 are included for guidance only and are not intended to be exhaustive and the Hong Kong Stock Exchange may take into account of other factors relevant to a particular case in assessing independence, one would expect the inclusion of a director's length of tenure as one of the factors if it is considered an important factor that may impair a director's independence.

<u>A long-serving director is an asset rather than a liability</u>

A director's familiarity with an issuer's operations and practices is an asset to the issuer rather than a liability. Long tenure bring benefits, including continuity of organizational knowledge, credibility in the market and improved board dynamics and collegiality. Often, these benefits have clearly led to improved performance. Greater board stability is often associated with improvement in performance. Because of these benefits, long tenure may place a long-serving director in a better position to contribute independent views. His long association with the issuer may better enable him to provide a robust and effective challenge to management because of the sound and detailed knowledge of the issuer's business that he has developed.
Long tenure is necessary as businesses are becoming more complex and changing more rapidly, so that it is increasingly difficult for directors to keep abreast of changes to technology, financial dealings, and business strategies.For financial organisations which operate in a very complex operational environment, such as banks after the global financial crisis triggered by the collapse of the Lehman Brothers group, it will take a long time for any newly appointed director to really understand what is going on. For issuers operating in a very complex operating environment, the inclusion of long-standing directors on the board is often beneficial in helping the issuer understand longer term issues which may affect the issuer's investment strategy and the impact of the economic cycle.

<u>The proposed 9-year rule restricts the pool of potential non-executive directors</u>

The 9-year is arbitrary and may lead to issuers losing competent directors prematurely. Term limits may result in the departure of board members who are making significant contributions and whose departure would be a significant loss to the issuer. For example, an independent director in the midst of a project during which term he crosses the nine-year threshold may have to leave. The 9-year rule hinders the effective operation of boards by restricting the pool of potential non-executive directors, which would be detrimental for all listed issuers generally. This is


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exacerbated by the fact that the pool of good independent non-executive directors in Hong Kong is not large enough. There are genuine concerns about the difficulties in getting willing and suitable candidates to be appointed to the boards of listed issuers. While Hong Kong may have a large pool of professionals such as retired lawyers and accountants who can take up the role, it does not necessarily follow that these retired professionals would be willing to actually take up the role given the increasingly demanding role that a director has to assume. One just has to look at the recent high-profile enforcement against individual directors by the Securities and Futures Commission under the so-called "corporate governance" provisions of the Securities and Futures Ordinance. Without a larger pool of good independent non-executive directors in Hong Kong, existing independent non-executive directors may be asked to become directors on a greater number of boards which in turn may result in these directors having less time to devote to their duties at each issuer. While Hong Kong has long been an international financial centre and should therefore have a sufficient number of persons whose knowledge and expertise is adequate for the independent non-executive director role, the reality is that the pool of good independent non-executive directors in Hong Kong is not large enough. The potential impact on the 9-year rule on listed issuers should be carefully considered and it should also be recognised that issuers may need time to reconfigure their boards and board committees to meet this new requirement. The implementation of the 9-year rule will probably be costly and it should not apply equally to both large and small issuers.If the 9-year rule is to be implemented, more time should be given to comply with it.

<u>Other jurisdictions</u>

There is no similar requirement as that proposed in respect of the 9-year rule in other jurisdictions. While the UK Combined Code on Corporate Governance states that all non-executive directors who have served longer than nine years should be subject to annual re-election, there is no requirement that shareholders vote on a separate resolution to retain a director.

The Australian Code only states that issuers should disclose to shareholders the length of service of directors who are up for re-election to allow them to make informed decisions on their independence when voting. Singapore in its recent consultation has also considered this issue, and it concluded that a director who has served more than 9 years can still remain as a non-independent director on the board, as long as requirements in relation to the composition of the board are met.

<u>Existing measures for safeguarding independence adequate</u>

For the reasons stated above, it is submitted that it is neither necessary nor desirable to upgrade the recommendation that shareholders vote on a separate resolution to retain a director who has served on a board for more than nine years from RBPA.4.3 to a CP (re-numbered CP A.4.3). It is further submitted that existing measures for safeguarding the independence of non-executive directors are adequate. These measures include the requirements that upon his initial appointment an independent non-executive director shall submit to the Hong Kong Stock Exchange a written confirmation which must state:



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(a) his independence as regards each of the factors referred to in Rule 3.13(1) to (8) of the Listing Rules;
(b) his past or present financial or other interest in the business of the issuer or its subsidiaries or any connection with any connected person (as such term is defined in the Listing Rules) of the issuer, if any; and
(c) that there are no other factors that may affect his independence at the same time as the submission of his declaration and undertaking in Form B or H of Appendix 5 to the Listing Rules.

Each independent non-executive director shall also inform the Hong Kong Stock Exchange as soon as practicable if there is any subsequent change of circumstances which may affect his independence and must provide an annual confirmation of his independence to the listed issuer. In addition, the Nomination Committee of a listed issuer is mandated to assess annually the independence of all independent non-executive directors and to affirm if each of them satisfies the criteria of independence as set out in the Listing Rules. The listed issuer must also confirm in each of its annual reports whether it has received the annual independence confirmations from its independent non-executive directors and whether it still considers each of its independent non-executive director to be independent. Besides, the Hong Kong Stock Exchange is not restricted by the factors set out in Rule 3.13 and may take into account of other factors relevant to a particular case in assessing independence.

Furthermore, the Listing Rules also impose requirements in relation to the composition of the board which include the requirements that every board of directors should at least has three independent non-executive directors and at least one of the independent non-executive directors must have appropriate professional qualifications or accounting or related financial management expertise. As mentioned above, Singapore has in its recent consultation considered this issue and concluded that a director who has served more than 9 years can still remain as a non-independent director on the board, as long as requirements in relation to the composition of the board are met.

We appreciate your consideration of our comments. If you have any questions concerning our foregoing submission, please do not hesitate to contact us.

Yours faithfully,

For and on behalf of
Wing Hang Bank, Limited



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