

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEx website at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201406.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with our proposal to amend the title of Section C.2 of the Code to "Risk management and internal control"?

☒ Yes

☐ No

Please give reasons for your views.

The expanded title will be a more fitting one that better describes the wider scope of the section.

2. Do you agree with the proposed amendments to Principle C.2 to define the roles of the board and the management, and state that the management should provide assurance to the board on the effectiveness of the risk management systems? Is the intention of the proposed wording sufficiently clear?

☒ Yes

☐ No

Please give reasons for your views.

It is important to clearly delineate the respective responsibilities of various functions within a listed company in particular the board, management and internal audit. This adds clarity for all stakeholders. Therefore, we support the use of clear and unambiguous language in the Code to define the roles of the board, the executive and the control functions.

AIA considers that the board has ultimate oversight of risk management and is responsible for determining what level of risk will be taken by the company; that is the company's risk appetite.

The executive management of the business are then responsible for ensuring that the business operates within the risk appetite defined by the board. It is part of the terms of reference of AIA's board Risk Committee that management provides assurance to the Committee regularly as to the effectiveness of the risk management framework on an on-going basis. AIA's risk management framework is described in detail in the Risk Management section of AIA's annual report.

On the proposed revisions to C.2, AIA believes that it is also important:

(a) To revise the proposal so that the board's role is to evaluate and determine the nature and extent of the risks it wishes to take or not take. This approach is consistent with the board's role in overseeing management in the design, implementation and monitoring of the risk management control system. Thus, we believe it is important to clarify that the board should determine the nature of risks it is willing to take or not take in achieving the issuer's strategic objectives.

(b) To clarify that executive management should provide on-going, as opposed to a point in time, assurance to the board that the risk management system is operating effectively, consistent with, and necessary to, the current proposed framework which involves the board providing on-going oversight of risk management.

Accordingly, we suggest the following revisions to the wording:

"The board is responsible for evaluating and determining the nature and extent of the risks it is willing to take and not to take, that is the risk appetite of the company.....and management should provide assurance to the board on an on-going basis that these systems are operating effectively the effectiveness of these systems."

3. Do you agree with our proposal to introduce an amended RBP (C.2.6) to provide that the board may disclose in the Corporate Governance Report that it has received assurance from management on the effectiveness of the issuer's risk management and internal control systems? Is the intention of the proposed wording sufficiently clear?

☐ Yes

☒ No

Please give reasons for your views.

We agree that such disclosure should be made, but we believe that this should be a CP. RBPs are voluntary and seem to have a low level of adoption amongst listed companies. An RBP thus does not exert sufficient influence to achieve the required disclosure. Whether the board has, or has not, received assurance from management is a significant matter.

The disclosure requirement will serve as an additional incentive for issuers to identify and address risk management issues in a timely manner. It should be noted again, as we have mentioned in our answer to Question 2, that if there are issues with risk management, these must be addressed by listed issuers as soon as these are identified, which is not necessarily around the time of the annual report.

4. Do you agree with the proposed amendments to CP C.2.1 to state that the board should oversee the issuer's risk management and internal control systems on an ongoing basis? Is the intention of the proposed wording sufficiently clear?

☒ Yes

☐ No

Please give reasons for your views.

The proposed amendment is helpful in clarifying that the board's obligation is an on-going one and not a one-off obligation.

We note the Exchange's statement that there is no difference between the meaning of "board" and "the directors". The change is intended to simply make the language consistent with other parts of the Code.

In AIA the ongoing review of risk management is conducted by a dedicated board Risk Committee made up of mostly non-executive directors who meet at least quarterly to review AIA's risk profile. Their activities are reported to the board and they also advise the board on any matters on which the board are required to approve or which the board request. We believe this governance structure allows greater focus on ongoing risk management and therefore propose that the Rules make clear that a board-level Risk Committee can assist the board in fulfilling its obligation for ongoing oversight of risk management.

We also note that the proposed amendments specifying the board should oversee the issuer's risk management is in line with practices in other key jurisdictions.

5. Do you agree with our proposal to upgrade to a CP the existing RBP C.2.3, which sets out the matters that the board's annual review should consider?

☒ Yes

☐ No

Please give reasons for your views.

The amendment will add clarity to what stakeholders can expect in the board's annual review including setting the standard for what issuers should consider.

6. Do you agree with our proposal to upgrade to a CP the existing RBP C.2.4, which sets out the particular disclosures that issuers should make in their Corporate Governance Reports in relation to how they have complied with the internal control CPs during the reporting period?

☒ Yes

☐ No

Please give reasons for your views.

By and large, the amendment will facilitate comparison amongst listed companies. We support the requirement for companies to explain that the risk framework (a) will manage rather than eliminate risks and (b) can only provide reasonable not absolute assurance against material misstatement or loss. However, provided that these two fundamental points are satisfactorily made, it should be upto the company to decide the exact wording of such disclosure. This is important because there is no 'one size fits all' wording and it is important to give companies the opportunity to differentiate their risk appetite.

7. Do you agree with our proposal to amend the wording of proposed CP C.2.4 to simplify the requirements and remove ambiguous language, and to make clear that the risk management and internal control systems are designed to manage rather than eliminate risks? Is the intention of the proposed wording sufficiently clear?

☒ Yes

☐ No

Please give reasons for your views.

Please see our answer to question 6.

8. In relation to proposed CP C.2.4, do you agree with our proposal to upgrade the existing recommendation that issuers disclose their procedures and internal controls for handling and disseminating inside information (Section S., paragraph (a)(ii)), and amend it to include the handling of "other regulatory compliance risks"?

☒ Yes

☐ No

Please give reasons for your views.

The amendments will facilitate comparison amongst public companies.

9. Do you agree with our proposal to upgrade to Mandatory Disclosures the following existing Recommended Disclosures in relation to internal controls (Section S.):

- (a) whether the issuer has an internal audit function;
- (b) 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;
- (c) a statement that a review of the effectiveness of the risk management and internal control systems has been conducted and whether the issuer considers them effective and adequate; and
- (d) significant views or proposals put forward by the audit committee?

☐ Yes

☒ No

Please give reasons for your views.

We agree with amendments (a)-(c). We do not see the benefit of prescribing disclosure of the matters in (d) ("significant views or proposals put forward by the audit committee.") These matters – or views or proposals – should they require disclosure, are already subject to the issuer's general obligations to disclose inside information (price sensitive information) under the Securities and Futures Ordinance ("SFO") and the Listing Rules. The issuer's board should have the discretion to determine what if anything is required to be disclosed in terms of "proposals" or "views" put forward by the audit committee. This includes a prompt announcement if the significance of the matter requires (as opposed to waiting until the time of the annual report.)

10. Do you agree with our proposal to move the existing recommendation that issuers disclose details of any significant areas of concern (Section S., paragraph (a)(ix)) to a new RBP C.2.7, and to amend the provision to widen its application by removing the reference to areas of concern "which may affect shareholders"?

☒ Yes

☐ No

Please give reasons for your views.

We agree with introducing this RBP which by definition will be voluntary. We suggest adding a Note that this RBP is notwithstanding the obligations under existing regulations in particular the SFO and Chapter 13 of the Rules to make timely announcements (as opposed to waiting until the time of the next periodic report), given at issue are significant areas of concern.

11. Do you agree with our proposal to remove RBP C.2.5, which states that issuers should ensure their disclosures provide meaningful information and do not give a misleading impression?

☒ Yes

☐ No

Please give reasons for your views.

These obligations exist already under applicable law and regulations. Having the separate RBP is likely to confuse rather than clarify, or at least not add any significant benefit.

12. Do you agree with our proposals to remove the recommendations that issuers include in their Corporate Governance Reports:

(a) an explanation of how the internal control system has been defined for them (Section S., paragraph (a)(i)); and

(b) the directors' criteria for assessing the effectiveness of the internal control system (Section S., paragraph (a)(vii))?

☒ Yes

☐ No

Please give reasons for your views.

This overlaps with other requirements of the Listing Rules e.g. see C 2.4.

13. Do you agree with our proposal to upgrade RBP C.2.6 to a CP (re-numbered C.2.5) and amend it to state that an issuer should have an internal audit function, and issuers without

an internal audit function should review the need for one on an annual basis and disclose the reasons for the absence of such function in the Corporate Governance Report? Is the intention of the proposed wording sufficiently clear?

☒ Yes

☐ No

Please give reasons for your views.

Internal audit plays a critical role as a third line of defence in a sound risk management framework.

14. Do you agree with our proposal to introduce new Notes to the proposed CP C.2.5 to clarify that:

(a) the role of the internal audit function is to carry out the analysis and independent appraisal of the adequacy and effectiveness of an issuer's risk management and internal control systems; and

(b) a group with multiple listed issuers may share group resources of the holding company to carry out the internal audit function for members of the group?

☒ Yes

☐ No

Is the intention of the proposed wording sufficiently clear? Please give reasons for your views.

Proposal (a) adds clarity for all stakeholders. Proposal (b) is a practical and sensible solution in managing resources.

15. Do you agree with our proposal to amend the existing CP C.2.2 to state that the board's annual review should ensure the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's internal audit function (in addition to its accounting and financial reporting functions)?

☒ Yes

☐ No

Please give reasons for your views.

This adds clarity and focuses listed companies' attention on these important issues related to the effectiveness of internal audit. However, we suggest adding an explanatory note to the Code to make clear that this should be delegated to the audit committee, for example as part of their review of the audit plan, especially as it is logical that any review of the audit plan will naturally consider the ability of the internal audit function to fulfil it. We note that currently CP 3.3(i) is clear that the audit committee's terms of reference includes (where the issuer has an audit committee) ensuring that the internal audit function is adequately resourced and has appropriate standing within the issuer, and to review and monitor the internal audit function's effectiveness.

16. Do you agree with our proposal to amend Principle C.3 in respect of audit committees and CP C.3.3 in respect of their terms of reference to incorporate "risk management" where appropriate?

☒ Yes

☐ No

Please give reasons for your views.

This adds consistency amongst the internal controls and audit committee sections of the Code, which already provides that the audit committee has identified risk management and internal control responsibilities.

However, we suggest adding a note clarifying that where the listed company has a risk committee, these functions may fall within the ambit of the risk committee's responsibilities and the terms of reference of the audit committee should be refined accordingly.

17. Do you agree that the matter of establishing a separate board risk committee should be left to issuers to decide in accordance with their own circumstances?

☒ Yes

☐ No

Please give reasons for your views.

There is no 'one size fits all' solution. The matter should be left to the judgment of the board.

18. What would be an appropriate period of time between the publication of the consultation conclusions and the implementation of the amendments set out in the Consultation Paper?

- ☒ Six months
- ☐ Nine months
- ☐ 12 months
- ☐ Others (please specify:)

Please give reasons for your views.

Given these amendments are important and not particularly onerous to comply with they should be introduced promptly.

- End