

Freshfields' response to HKEX Consultation Paper on Review of Corporate Governance Code and Related Listing Rules

Question 1:	Do you agree with our proposal to introduce a CP requiring an issuer's board to set culture in alignment with issuer's purpose, value and strategy?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange's proposal to introduce a CP requiring a listed issuer's board to set culture in alignment with the listed issuer's purpose, value and strategy.</p> <p>Disclosure of a listed issuer's culture could help investors understand how its culture allows it to further its strategy. We hope this will not degenerate into a box-ticking exercise.</p> <p>We look forward to seeing the Exchange's guidance to explain the board's role in culture and to set out the key elements commonly identified in a sound culture. We hope that the guidance will be instructive but not overly prescriptive, so as to allow listed issuers to explain their culture in their own ways, as every company is unique. We agree that there is no "one-size-fits-all" when it comes to culture.</p>
Question 2:	Do you agree with our proposal to: (a) introduce a CP requiring establishment of an anti-corruption policy; and (b) upgrade a RBP to CP requiring establishment of a whistleblowing policy?
A:	<p>Answer: Yes.</p> <p>Given the importance of: (i) managing conflicts of interest; and (ii) having an independent mechanism to identify potential misconduct, an effective anti-corruption policy and whistleblowing policy are potentially critical components of a listed company's corporate culture and governance. For those reasons, we agree with setting out the requirements in the Code. This would also help demonstrate clearly the SEHK's expectation on the prevention of misconduct and handling of improprieties when they occur in a listed company.</p> <p>We suggest building into the proposed CPs D.2.6 and D.2.7 a requirement for a company to monitor on an ongoing basis the effectiveness of its anti-corruption policy and whistleblowing policy, and to review (and update, where appropriate) the policies annually, or whenever a need for updates arises. This is broadly in line with the recommendations under the ICAC's Guide for Listed Companies. The Board should be apprised of any material non-compliance.</p>

Question 3:	Do you agree with our proposal to introduce a CP requiring disclosure of a policy to ensure independent views and input are available to the board, and an annual review of the implementation and effectiveness of such policy?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to introduce a CP requiring disclosure of a policy to ensure independent views and input are available to the board, and an annual review of the implementation and effectiveness of such policy.</p> <p>We are of the view that mechanisms should be in place to safeguard the ability of an INED to: (i) scrutinise the board’s major decisions and the issuer’s performance; (ii) make independent judgments free from the influence of any interests; and (iii) initiate independent studies of special issues, through engaging external advisers. These elements have been set out in the Guidance for Boards and Directors published by the Exchange in July 2018.</p>
Question 4(a):	Do you agree with our proposal regarding re-election of Long Serving INEDs to revise an existing CP to require (i) independent shareholders’ approval; and (ii) Additional Disclosure?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees that it is important to strike a careful balance between ensuring director independence and accountability on one hand, and ensuring the quality of service that INEDs could provide to the Board on the other. Long Serving INEDs often bring valuable contributions to the company that might be difficult to replace by a new INED, either due to the former’s familiarity with the operations and dynamics of the company, and/or because of the unique skill set and expertise of the Long Serving INED – indeed it might be worth considering whether this (aside from the currently limited pool of available INEDs) could have contributed to the prevalence of Long Serving INEDs as referenced in this consultation paper.</p> <p>Nevertheless, one should also bear in mind the critical role that INEDs play as independent gatekeepers in scrutinising the Board’s decisions to ensure that they are in the best interests of the company as a whole – this is particularly important given Hong Kong’s market structure, where the level of institutional investor participation generally remains lower than in other major markets such as the US, UK or Australia, and concentrated ownership is common. Giving independent shareholders a voice in determining whether a Long Serving INED is still independent and suitable is therefore a positive step towards enhancing the corporate governance standards of issuers.</p> <p>We also agree that the current practice of issuers relying on the independence criteria under MB Rule 3.13 (which does not contain any reference to lengths of tenure) to justify the re-appointment of a Long Serving INED may be inadequate. Additional disclosure, including the reasons behind the re-election, and how that decision was arrived at, would be helpful in ensuring transparency for shareholders. This would also distinguish the cases of INEDs who warrant re-election due to the unique</p>

	<p>contributions that they could bring to the Board, as explained above. Allowing independent shareholders to vote on the suitability of Long Serving INEDs, rather than imposing a hard-stop nine-year limit, can strike a balance between maintaining INED independence and expertise, something that the Singapore Corporate Governance Council seemed to agree with during its deliberation of the latest round of CG reform proposals. We note that the Singapore CG Council has also raised the alternative of Long Serving INEDs being re-designated as non-independent directors, which should help address concerns about potential compromise of independence due to long tenures, while retaining valuable INED skills.</p>
Question 4(b):	Do you agree with our proposal to introduce a CP requiring an issuer to appoint a new INED at the forthcoming AGM where all the INEDs on the board are Long Serving INEDs, and disclosing the length of tenure of the Long Serving INEDs on the board on a named basis in the shareholders' circular?
A:	<p>Answer: Yes.</p> <p>We agree in principle with the requirement to appoint a new INED in order to aid board refreshment – however we question the effectiveness of one single refreshed INED in breaking through any existing “group think” on the Board. Nevertheless, this is the right direction of travel which might encourage further progress in board diversity in the future.</p>
Question 5:	Do you agree with our proposal to introduce a new RBP that an issuer generally should not grant equity-based remuneration (e.g. share options or grants) with performance-related elements to INEDs as this may lead to bias in their decision-making and compromise their objectivity and independence?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the proposal to introduce a new RBP that an issuer generally should not grant performance-based equity awards (including share options) to INEDs. The role of INEDs is to provide independent oversight of the issuer and its management. Independence stems from the ability of INEDs to exercise objective judgement after fair consideration of all relevant information and views without undue influence from internal or external parties. For this reason, it is important that the remuneration of INEDs is structured in a way which does not compromise, or is not perceived to compromise, their objectivity and independence. However, we believe that INEDs should be remunerated in a way which reflects their responsibilities and the time and effort they are expected to devote to their role. As such, we do not think that the RBP should preclude the granting of equity awards to INEDs generally – the restriction should be limited to any equity awards which are linked to performance-based conditions.</p>

Question 6(a):	Do you agree with our proposal to highlight that diversity is not considered to be achieved by a single gender board in the note of the Rule?
A:	<p>Freshfields agrees with including the proposed statement. However, we believe that the impact would be greater if the statement was placed within in Rule 13.92 rather than in the notes to this rule. We also think that a similar statement should be included in section J of PART 1 - MANDATORY DISCLOSURE REQUIREMENTS under Diversity.</p> <p>Whilst we are delighted to see a proposal to require existing issuers with single-gender boards a three-year transition period to appoint at least one director of the absent gender on their boards and IPO applicants are not expected to have single gender boards, we worry about the real risk of tokenism and also question whether the proposed transitional period is far too long given the breadth of female talent in Hong Kong. Numerous researches have indicated that to be effective on the board, three is the magic number as boards tend to benefit the most from contributions of three or more individuals who are not of the same gender as the rest of the board members.¹ Critical mass is needed for any impact to be made.</p> <p>We further propose that a rule should be made that new issuers cannot list with a single gender board and should have at least 2 (preferably 3) female directors at the time of listing.</p>

¹ Mariateresa Torchia, Andrea Calabrò and Morten Huse, “Women Directors on Corporate Boards: From Tokenism to Critical Mass”, Journal of Business Ethics, Vol. 102, No. 2 (August 2011), pp. 299-317 (19 pages), Published By: Springer,

Torchia, M., Calabrò, A., Huse, M., & Brogi, M. (2010). “Critical mass theory and women directors’ contribution to board strategic tasks. Corporate Board: role, duties and composition”, 6(3), 42-51. <https://doi.org/10.22495/cbv6i3art4>

Carolyn Wiley and Mireia Monllor-Tormos, “Board Gender Diversity in the STEM&F Sectors: The Critical Mass Required to Drive Firm Performance,” Journal of Leadership & Organizational Studies, vol. 25, no. 3 (January 2018).

Question 6(b):	Do you agree with our proposal to introduce a MDR requiring all listed issuers to set and disclose numerical targets and timelines for achieving gender diversity at both: (a) board level; and (b) across the workforce (including senior management)?
A:	<p>Answer: Yes, but we should aim higher.</p> <p>Freshfields agrees with the introduction of a Mandatory Disclosure Requirement (MDR) requiring all issuers to set and disclose numerical targets and timelines for achieving gender diversity at both board level and across the workforce. Instead of issuers setting their own voluntary targets and timelines, we should aim higher and consider requiring issuers to set a mandatory target (if the word quota is to be avoided) of 40% of board members being women by 2028 or 6 years after such requirement becomes effective, across all levels including, in particular, senior management.</p> <p>To remain competitive amongst our international peers such as London or New York, which have exceeded or are close to reaching the target of 30% board gender diversity (34.3% in the UK, 28.2% in USA, respectively on the MSCI ACWI 2020), we should aim higher than 30% and set a quota of 40% by 2028. By then, it is expected that our Asian peers would have also caught up (e.g. Singapore and Malaysia which are currently at 19.5% and 28.1%).</p> <p>Instead of striving to catch up, we should strive to lead — at least in Asia. Six years is a long time for corporates to embrace this change (or accelerate the pace with earlier appointments) and for females to prepare for these opportunities. We also support long term planning and should encourage corporates to do so.</p> <p>We also propose that issuers establish a diversity policy that is applicable across the issuer (board, management, senior management and workforce generally) and not only in relation to the board and that the necessary changes be made to Rule 13.92. Asking issuers to set targets and timelines for workforce gender diversity without a requirement for an associated policy applicable to the whole company will not aid issuers in reaching targets. Such a policy should take into account other aspects of diversity such as race, disability and/or age.</p> <p>We propose a requirement for the issuer to set measurable objectives for implementing its diversity policy.</p> <p>We further propose that issuers are required, in addition to the current proposals to disclose in relation to each reporting period, to set out: (1) the measurable objectives set for that period to achieve gender diversity; (2) the entity’s progress towards achieving those objectives; (3) the respective proportions of men and women on the board, in management and senior management positions and across the whole workforce.</p>

	<p>There is some uncertainty as to what is meant by the “whole workforce”, so some guidance from the Exchange will be helpful. We expect the term to mean employees, full- or part-time of the whole listed organisation including subsidiaries, whether incorporated in Hong Kong or elsewhere. The Exchange should consider if this definition should be extended to cover key contractors where they are critical to the business of the relevant companies.</p>
Question 6(c):	Do you agree with our proposal to introduce a CP requiring the board to review the implementation and effectiveness of its board diversity policy annually?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the proposal to introduce a CP requiring the board to review the implementation and effectiveness of its board diversity policy annually.</p> <p>We propose to amend the proposal so that an issuer’s diversity policy is applicable across the issuer (board, management, senior management and workforce generally) and not only in relation to the board (to align with proposals in 6(a) and 6(b)).</p>
Question 6(d):	Do you agree with our proposal to amend the relevant forms to include directors’ gender information?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the proposal to amend the relevant forms to include directors’ gender information. We suggest the relevant forms to ensure that gender information includes non-binary gender options.</p> <p>We also propose establishing a public database that includes analysis updated biannually to include: percentage of women on boards on HSI; percentage of women on boards across all issuers; percentage of women appointed to the boards of new IPO issuers and the number and percentage of women appointed to boards in the foregoing period compared to the number of men.</p>
Question 7:	Do you agree with our proposal to upgrade a CP to Rule requiring issuers to establish a NC chaired by an INED and comprising a majority of INEDs?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to upgrade a CP to Rule requiring listed issuers to establish a NC chaired by an INED and comprising a majority of INEDs.</p>

	<p>The NC is a key gatekeeper in the appointment and re-appointment of directors, as well as succession planning and evaluation of the board. Effectiveness of the NC to a large extent depends on the effectiveness of its chairman who leads the assessment of the board/individual directors and the conversations on succession planning, particularly for the next chairman of the board. If the chairman of the NC is the same as the chairman of the board, this may lead to lack of oversight by the NC on the chairman of the board. We therefore support the requirement of establishing a NC chaired by an INED and comprising a majority of INEDs.</p>
Question 8:	Do you agree with our proposal to upgrade a CP to a MDR to require disclosure of the issuer’s shareholders communication policy (which includes channels for shareholders to communicate their views on various matters affecting issuers, as well as steps taken to solicit and understand the views of shareholders and stakeholders) and annual review of such policy to ensure its effectiveness?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to upgrade a CP to a MDR to require disclosure of the issuer’s shareholders communication policy and annual review of such policy to ensure its effectiveness.</p> <p>It is important for listed issuers to put in place a shareholder communication policy to maintain and promote effective communication and ongoing dialogue with their shareholders, so as to enable their shareholders to engage actively with them through different means of communication and exercise shareholders’ rights in an informed manner. We believe this new requirement could raise the standard and effectiveness on listed issuers’ communications with their shareholders in general.</p>
Question 9:	Do you agree with our proposal to introduce a Rule requiring disclosure of directors’ attendance in the poll results announcements?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to introduce a Rule requiring disclosure of directors’ attendance in the poll results announcements.</p> <p>We trust that the timely provision of attendance records of directors will provide greater transparency and allow shareholders and investors to assess directors’ commitment in listed issuers’ affairs.</p>
Question 10:	Do you agree with our proposal to delete the CP that requires issuers to appoint NEDs for a specific term?
A:	Answer: Yes.

	<p>Freshfields agrees with the Exchange’s proposal to delete the CP that requires listed issuers to appoint NEDs for a specific term (“Specific Term CP”).</p> <p>The intended purpose of a Specific Term CP is to prevent entrenchment. This is already achieved by the rotation requirement under the articles of association or by-laws of listed issuers.</p>
Question 11:	Do you agree with our proposal to elaborate the linkage in the Code by (a) setting out the relationship between CG and ESG in the introductory section; and (b) including ESG risks in the context of risk management under the Code?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to elaborate the linkage in the Code by (a) setting out the relationship between CG and ESG in the introductory section; and (b) including ESG risks in the context of risk management under the Code.</p> <p>The board should be responsible for governance of ESG matters and management of material environmental and social risks. Therefore, the linkage between the Code and ESG should be clearly articulated.</p>
Question 12:	Do you agree with our proposal to amend the Rules and the ESG Guide to require publication of ESG reports at the same time as publication of annual reports?
A:	<p>Answer: Yes.</p> <p>Freshfields agrees with the Exchange’s proposal to amend the Rules and the ESG Guide to require publication of ESG reports at the same time as publication of annual reports.</p> <p>ESG information is becoming increasingly important. Investors would benefit from ESG data that is current. The alignment of the publication timeframes of ESG reports and annual reports would enable listed issuer’s board to assess the ESG-related risks and financial risks that it is facing in a more holistic way and lead to more comprehensive and meaningful disclosure for investors.</p>
Question 13:	Do you have any comments on how the re-arranged Code is drafted in the form set out in Appendices III and IV to this paper and whether it will give rise to any ambiguities or unintended consequences?
A:	Freshfields does not have further comments.

Question 14:	In addition to the topics mentioned in this paper, do you have any comments regarding what to be included in the CG GL which may be helpful to issuers for achieving the Principles set out in the Code?
A:	Freshfields does not have further comments.
Question 15:	Do you agree with our proposed implementation dates of: (a) for all proposals (except the proposals on Long Serving INED): financial year commencing on or after 1 January 2022; and (b) for proposals on Long Serving INED: financial year commencing on or after 1 January 2023?
A:	The Exchange can consider offering encouragement for listed issuers to act faster, for example, achieving gender diversity earlier than the prescribed deadline(s) by highlight this on the website of HKSE.