

25 June 2021

Hong Kong Exchanges and Clearing Limited  
8<sup>th</sup> Floor, Two Exchange Square  
8 Connaught Place  
Central  
Hong Kong

By email: [REDACTED]

**Re: Consultation Paper on the Review of the CG Code**

Dear Sir/Madam,

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in Hong Kong in 1999. We conduct independent research on corporate governance and ESG, and advocate at the regulatory and corporate level across Asia-Pacific to improve standards and practices. ACGA is entirely funded by a network of 112 member firms, of which 80% are institutional investors with more than US\$42 trillion in assets under management globally.

We welcome the opportunity to respond to the HKEX consultation paper on the “Review of Corporate Governance Code and Related Listing Rules”. Our submission first addresses the areas in the revised Code that we believe take corporate governance in Hong Kong forward in a constructive way. We then highlight some specific areas of concern, followed by reforms that we would have liked to see included in the revised Code. Our overall conclusion is that the proposals in the consultation paper are somewhat lacking in ambition and that much bolder steps are now necessary to modernise the governance of Hong Kong-listed companies. This would not only strengthen the governance and reputations of these firms, it would make them better prepared to deal with the wide range of environmental and social risks facing companies and communities in the coming years. It would also help immeasurably to reinforce Hong Kong’s position as *the* international finance centre in China.

A few areas where the CG Code could go much further include, but are not limited to:

- Setting a quota and timeframe for gender diversity on boards.
- Introducing the lead independent director concept.
- Making board committee reporting meaningful.
- Providing guidance to boards on preparing for climate change.
- Encouraging a more open nomination process for independent directors.
- Strengthening the independent election of independent directors.

**HIGH-LEVEL COMMENT**

**IPO Guidance**

The introduction to the consultation paper emphasises the importance of corporate governance preparation by listing candidates prior to their IPO. It states that boards are “collectively responsible for ensuring that the IPO applicant builds the necessary governance mechanisms into the listing process, so that these are up and running immediately upon listing”. It then references the updated guidance provided to listing applicants in a July 2020 letter. This document goes somewhat further and states (in full):

“It is important for applicants to put in place mechanisms that enable them to meet the Exchange’s requirements on corporate governance (“**CG**”) and environmental, social and governance (“**ESG**”) well in advance so that they are in compliance upon listing. The board of directors of an applicant is collectively responsible for its management and operations, including the establishment of such mechanisms. Directors are expected to be involved in the formulation of such mechanisms and related policies. (underlining added)

“Applicants are therefore recommended to appoint directors (including independent non-executive directors) as early as possible so that directors can engage in the formulation of the necessary mechanisms and policies on CG and ESG.” (underlining added)

We would like to commend the Exchange for including this message in the consultation paper and for revising the IPO guidance letter in 2020. This is an issue that ACGA has been focussed on for more than a decade and it has long been one of the missing ingredients in the IPO process in Hong Kong. Many companies come to market with weak governance structures, thus raising investment risk, regulatory risk for issuers, and adds to the regulatory workload. We made a series of practical recommendations on this topic in a July 2012 [submission](#) to the Securities and Futures Commission on its consultation regarding IPO sponsors. We also touched upon it in our December 2017 [submission](#) to HKEX on its last revision of the CG Code.

Going forward, we recommend that the Exchange develop further guidance around what phrases such as “well in advance” and “as early as possible” mean in concrete terms. Suggestions to companies on the specific actions they should undertake and over what timeframe would also be useful. We note that the HKEX publication, “Making inroads into good Corporate Governance and ESG management: Perspectives from industry practitioners”, published in December 2020, goes some way towards providing such guidance. However, much more work could be done in this area.

## **POSITIVE PROPOSALS**

In terms of constructive ideas for moving corporate governance and ESG forward in Hong Kong, we particularly welcome the following proposed revisions to the Code and Listing Rules. The points are numbered in accordance with the consultation paper:

**1B. Anti-corruption and whistleblowing:** The focus on introducing new code provisions on the establishment of anti-corruption and whistleblowing policies is significant and follows enhanced disclosures required under the revised ESG Reporting Guide of 2019. While some may view this as merely a housekeeping matter (ie, bringing the Code into line with the ESG Guide), we hope these changes elevate the importance of corruption and whistleblowing in the eyes of company directors and executives.

We assessed the extent to which Hong Kong firms have clear and credible policies for addressing corruption in our recent CG Watch 2020 survey of 12 markets in Asia-Pacific. Unfortunately, Hong Kong scored only 2/5 on this question and rated lower than markets such as Taiwan and Korea that rank below Hong Kong in our survey overall. One factor for the underperformance of listed companies here may be the lack of extra-territorial powers accorded to the ICAC and the generally strict approach that the Commission has taken to bribery and other forms of corruption in Hong Kong. In other words, companies may believe that framing their own policies is not necessary. Whatever the reason, this is an area where Hong Kong could do much better.

We **agree** with the Exchange’s two proposals under Question 2.

**2B. Board refreshment and succession planning:** We support the introduction in the Code of a separate vote reserved for independent shareholders on any independent director who has served for more than nine years (called “long-serving INEDs in the paper). We agree that the AGM papers to shareholders should state why such INEDs should be re-elected and the process the board or nomination committee undertook in coming to this conclusion. This should be much more than a simple affirmation by the board that it considers the director to be independent and that he/she adds value to the board. It should include a description of the extent to which new candidates were considered, how these candidates were sourced (eg, were HR consultants engaged?), and how broad and deep is the company’s INED pipeline. Issuers should also state whether any of their independent institutional shareholders were consulted and the extent to which they apply a “skills matrix” in planning for board refreshment.

Some issuers may view these suggestions as ‘going too far’. We would note that Hong Kong is already behind other markets in the region, such as Malaysia and Singapore, in requiring a separate vote on long-serving INEDS. More interestingly, some of the largest companies in Korea now invite their institutional shareholders to nominate independent directors. If these markets can take such steps, why not Hong Kong?

Looking forward, we recommend that a separate vote for independent shareholders be applied from the start of an INED’s tenure. We appreciate that this is likely to sound excessively radical in the Hong Kong context, yet it would greatly enhance the legitimacy of such directors in the eyes of minority shareholders and enhance trust in both the companies that took this step and the Hong Kong market. We also believe that most independent shareholders would support any qualified and experienced INED candidate put forward following a thoughtful and well-organised nomination process.

Subject to the caveats above, we **agree** with the Exchange’s proposals in Question 4(a) and 4(b). Over time it would be good to firm these up as listing rules.

**2C. Equity-based remuneration to INEDs:** We strongly support the view that INEDs should not be given equity-based compensation. We are surprised, however, that the proposal is only to make this a “recommended best practice” (ie, not subject to “comply or explain” in the Code). This means that the measure can, and probably will, be easily ignored. We believe it should be upgraded to a code provision if not a listing rule.

We **do not agree** with the Exchange’s proposal in Question 5 as it does not go far enough.

**3. Diversity:** We welcome the statement that single-gender boards cannot be called diverse and that a note will be included in the listing rules to the effect that such boards are no longer acceptable. We also appreciate the way in which the Exchange has framed diversity as more of a gender issue than in the past and as encompassing both the board and management. When diversity was first raised in Hong Kong, it was understandably set in a narrower context (ie, relating only to the board) and included such things as age, ethnicity, experience and expertise as well as gender. These other types of diversity remain important, yet a lack of emphasis on gender has arguably contributed to the miniscule progress in this area. When we made a submission on the last revision of the CG Code in late 2017, the ratio of women directors in all Hong Kong listed companies was a mere 12.2%. Today it is still only about 13.7%, according to The Women’s Foundation, although the consultation paper quotes a lower ratio of 12.7%, drawn from an MSCI report. The paper goes on to say that almost one third of issuers (32.1%) have no women on their boards, while another 37% have only one. Here again Hong Kong is lagging several other markets in the region on either policy or practice, including India, Korea, Malaysia and Thailand.

In this context, we believe that the Exchange's proposals for taking forward gender diversity on boards—essentially firmer rules on the disclosure of targets and timelines, with an annual board review by the board—are insufficient to address the scale of the problem. We make a specific recommendation on this below.

We **agree** with the Exchange's proposals in Questions 6(a) and 6(d), but **do not agree** with its proposals in Questions 6(b) and 6(c) as not going far enough.

**4. Nomination committee:** We strongly support upgrading nomination committees from a code provision to a listing rule, requiring the chair to be an INED and a majority of members to be INEDs. Among other things this removes a long-standing loophole whereby the board chairman, who is normally a connected person, can chair the nomination committee, thus rendering its independence questionable.

We **agree** with the Exchange's proposal in Question 7.

**5. Communications with shareholders:** We welcome the emphasis on improved shareholder and stakeholder communication, and we appreciate the reaffirmation of the value of AGMs as a means to engage with shareholders. Specifically, the Exchange proposes to upgrade the code provision relating to an issuer's shareholder communications policy to a mandatory disclosure requirement.

While we broadly support this change, we are somewhat surprised that the consultation paper makes no mention of the Hong Kong stewardship code, namely the SFC Principles of Responsible Ownership, and how such codes are reshaping the relationship between issuers and institutional shareholders. Best practice among leading companies around the region is not merely improved disclosure, but a willingness to allow board directors, including INEDs, and senior executives to meet with shareholders. If shareholders are also the stewards of a company, should they not have some level of access to the board? While many understandably worry about the additional time burden on directors that such meetings may bring, there are ways in which such discussions can be facilitated to make them efficient and effective without the need for a multiplicity of one-on-one meetings.

We would also like to have seen the consultation paper address the issue of electronic shareholder meetings. As we highlighted in our recent CG Watch 2020 survey, few issuers among the top 50 by market cap in Hong Kong held any form of electronic meeting in 2020, thus disenfranchising shareholders from participating due to tight physical distancing rules. This was in marked contrast to five markets in the region that did encourage e-meetings: Australia, India, Malaysia, the Philippines and Singapore.

Furthermore, we would encourage the introduction of more specific yardsticks with which to monitor issuers' engagement with stakeholders. We recommend adoption of a provision similar to Principle 4 of the UK Code of Corporate Governance which states that "when 20% or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take to consult shareholders in order to understand the reasons behind the result." In addition, an update of the views of shareholders and action taken is to be published no later than six months after the shareholder meeting, with the board providing a final summary in the annual report.

On balance we **agree** with the Exchange's proposal in Question 8 but feel it could go much further.

## Part II: ESG

**A. Elaborate the linkage between CG and ESG:** Drawing clearer lines between corporate governance and ESG, in particular the role of the board in overseeing ESG issues and risks, makes good sense. Putting an emphasis on this in the introduction to the Code and including ESG risks in the risk management section is welcome.

For this to be effective, however, we believe the guidance in the Code needs to be of practical value to companies, not merely a series of high-level policy statements. For an elaboration of our recommendations here, please see the first chapter of our new CG Watch 2020, titled “Future Promise: Aligning governance and ESG in Asia”.

We **agree** with the Exchange’s proposals in Question 11, but feel this exercise needs to go further.

**B. Timely disclosure of ESG reports:** The proposal is to amend the listing rules and ESG Reporting Guide to mandate the publication of ESG reports at the same time as annual reports, thus bringing forward the deadline from five months to four months. Given the increasing need of investors for strategically relevant and financially material ESG information, it makes sense that such reporting be included in or alongside annual reports. As one ACGA member said: “It should all be integrated back to strategy, including environmental and social issues. If an E or S initiative is not adding value to a company, why are they doing it?” Indeed, there are also growing calls for ESG information to be included in the financial audit.

We **agree** with the Exchange’s proposal in Question 12.

## SPECIFIC CONCERNS

**Disclosure of AC’s work:** We agree that much reporting on audit and other board committees is boilerplate and non-meaningful. We also support the Exchange’s goal of encouraging issuers to provide more informative summaries of the work carried out by their board committees, which in relation to audit committees would include additional disclosure on their oversight of financial reporting, the work of external auditors, and how well internal audit and internal control are functioning. However, we question whether situating such advice in the “Guidance for Boards and Directors”, a supporting document to the Code, will have the desired effect. Although useful, this publication does not form part of the listing rules and is not subject to “comply or explain”.

We recommend that in addition to any practical advice incorporated into the Guidance, the Exchange amend the Code to emphasise the importance of meaningful and informative AC reports to shareholders, not just to the board (as the Code currently states).

**Deletion of the Specific Term CP:** We note that HKEX proposes to delete the code provision (CP) requiring issuers to appoint NEDs for a specific term on the basis that in practice, issuers tend to align the appointment term of directors with the period for rotation (ie, normally three years) for administrative convenience.

ACGA is concerned that indefinite terms of service send the wrong message to both directors and the market and urges the retention of specific terms. Tenure should be on a fixed basis to stimulate director performance and inhibit a culture of entrenchment on boards. Specific terms encourage a sense of renewal, rather than entitlement: by creating a fixed term, this encourages a regular review of whether the director’s appointment continues to be in the best interest.

### **Mandatory disclosure requirements: Chairman and Chief Executive**

Disclosure under this proposed amendment now only requires issuers to disclose the identity of the chairman and chief executive. The second part of the disclosure requiring a statement on whether the roles of the chairman and chief executive are separate and exercised by different individuals has been deleted. Given that there are still many boards in Hong Kong who have a person performing both roles, ACGA believes it is important for issuers to continue to make full and prominent disclosure of this circumstance in their annual report. This will alert potential shareholders to the situation. Issuers should continue to be forced to give reasons why they have not separated the chairman and chief executive role.

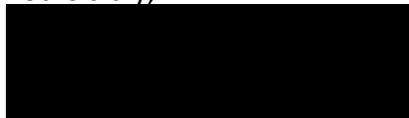
### **BOLDER STEPS**

There are number of issues not covered in the consultation, or not given due emphasis in our view, that we would like to highlight.

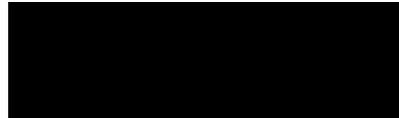
- **Gender diversity quota:** In our 2017 submission, we noted that it may be time for the Exchange to consider quantitative as well as qualitative targets for gender diversity on boards. Given the very slow pace of change in Hong Kong on this issue, we believe that it is time to set a firm quota of 30% women on boards within four years (ie, by 2025). While this may seem challenging, it is only slightly more than a doubling of the current low ratio of just under 14%. Moreover, Hong Kong could approach this creatively and phase in such a reform, starting with the top 100 to 200 listed firms. Phased CG reform is a feature of many other markets in Asia and has worked well, largely because it is seen as fair, sensibly targeted and economically efficient. We would also note, and not in jest, that a 30% quota for women still means a 70% quota for men. Any opponent to gender diversity on boards should explain why a 70% quota for men is not sufficient.
- **Lead independent directors:** This important issue gets a brief mention on p22 of the consultation paper under the section on “Communications with shareholders”, with a note that the Exchange will elaborate on the topic in the supporting “Guidance” document. As noted above, this means the proposal will not be subject to comply or explain, nor does it have any effect under the listing rules. We believe that this is a missed opportunity and once again sets Hong Kong well behind the curve in the region. We recommend including lead independent directors as a code provision in the Code.
- **Minimum three/one-third rule on INEDs:** This was another issue we raised in our 2017 submission on the last Code revision. There is not a great deal to add, except to say that this standard is becoming very long in the tooth and should be upgraded to half or a majority.
- **Low independent votes for directors:** The nature of corporate ownership in Hong Kong, with large family or state controlling shareholders, means that directors can be voted in despite a majority of independent shareholders voting against. We recommend that in such cases companies be required to make a statement explaining why such directors should remain on the board.

We appreciate the opportunity to respond to the consultation and would be pleased to discuss any of the points above further with the Exchange.

Yours truly,



Jamie Allen  
Secretary General



Jane Moir  
Research Director, Hong Kong