



9 August 2024

The Exchange, HKEX

SUBMISSION ON THE CONSULTATION PAPER ON CORPORATE GOVERNANCE CODE ENHANCEMENTS

Glass Lewis appreciates the opportunity to comment on the aforementioned Consultation Paper, which relates to proposed amendments to the Listing Rules and Corporate Governance Code applicable to Hong Kong issuers.

Founded in 2003, Glass Lewis is a leading, independent provider of global governance services that provides proxy research and vote management services to more than 1,300 clients throughout the world. While, for the most part, institutional investor clients use Glass Lewis research to help them make proxy voting decisions, they also use Glass Lewis research when engaging with companies before and after shareholder meetings.

Through Glass Lewis' web-based vote management system, Viewpoint, Glass Lewis also provides investor clients with the means to receive, reconcile and vote ballots according to custom voting guidelines and record, audit and disclose their proxy votes.

We have used the Corporate Governance Code to inform our own Glass Lewis voting policy guidelines, which in turn informs our proxy voting research. We view the Corporate Governance Code as a useful authority for informing the market as to local governance best practices and norms and see the periodic updates to the document as a seminal piece of work.

The responses provided below are not meant to be exhaustive but are designed to address what Glass Lewis sees as the main issues and concerns raised in the Consultation Paper. Thank you in advance for your consideration and please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail.

Respectfully submitted,

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Consultation Questions and Response

(A) Board Effectiveness

I. Designation of lead INED

Question 1. Do you agree with our proposal to introduce a new Code Provision (CP) under the Corporate Governance Code (CG Code) requiring issuers without an independent board chair to designate one independent non-executive director (INED) as a Lead INED to enhance engagement with investors and shareholders? Please provide reasons for your views.

Our Response to Question 1

Yes.

In our view, appointing a Lead INED will promote a more proactive and effective board of directors. This role ensures independent oversight of the company's executives and helps set a pro-shareholder agenda. Where the board chair is not independent, including when the role is combined with that of the CEO, the presence of a Lead INED can ensure an independent counterbalance to the chair and mitigate potential conflicts of interest, ensuring unbiased decision-making and enhancing corporate governance.

Given the relatively low regulatory threshold for board independence for Hong Kong listed companies, we believe the requirement to appoint a lead INED will help to promote an appropriate counterbalance.

Furthermore, we agree that a Lead INED may serve as a clear point of contact for shareholders and promote engagement, particularly among minority shareholders which is much welcomed given the prevalence of controlled companies in the market.

II. Mandatory director training

Question 2. Regarding continuous professional development for directors, do you agree with our proposals to:

- (a) Make continuous professional development mandatory for all existing directors, without specifying a minimum number of training hours?
- (b) Require First-time Directors to complete a minimum of 24 hours of training within 18 months following their appointment?
- (c) Define “First-time Directors” to mean directors who (i) are appointed as a director of an issuer listed on the Exchange for the first time; or (ii) have not served as a director of an issuer listed on the Exchange for a period of three years or more prior to their appointment?
- (d) Specify the specific topics that must be covered under the continuous professional development requirement?

Please provide reasons for your views.

Question 3. Do you agree with the proposed consequential changes to Principle C.1 and CP C.1.1 of the CG Code? Please provide reasons for your views.

Our Response to Question 2 and 3

Yes.

Glass Lewis welcomes the proposed code provisions to introduce mandatory continuous professional development for new and existing directors. As investors evaluate how boards are staying fit for purpose, enhanced disclosures on board education and how the board is executing oversight may help companies.

We welcome the proposed mandatory training for "First-time Directors" which we believe will help new board members become familiar with their role and responsibilities, including legal duties, and the organisation's structure and operations.

While 24 hours may be a reasonable number of training hours for a first-time director, we do not view the 18-month timetable to meet this requirement expresses enough urgency on this training. We suggest shortening the requirement to 12-months.

Increased board responsibility and expanding regulatory demands mean higher expectations for board performance. Glass Lewis believes that ongoing training for board members, in conjunction with regular board evaluation can help address any gaps identified in the knowledge of the board or an individual director. Continuous professional development can support the development of a director's skills and optimise their contribution to the board and allow directors to keep abreast of the latest developments in regulations and the operating environment.



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However, we fear that without specifying a minimum number of hours, some directors may in practice undertake very little ongoing continuous professional development. We suggest a minimum threshold is provided, even if light.

III. Board performance review

Question 4. Do you agree with our proposal to upgrade the current Recommended Best Practice (RBP) to a CP requiring issuers to conduct regular board performance reviews at least every two years and make disclosure as set out in CP B.1.4? Please provide reasons for your views.

Our Response to Question 4

Yes.

Glass Lewis strongly supports routine director evaluation, including independent external reviews, and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of the director evaluations, as opposed to relying solely on age or tenure limits.

IV. Board skills matrix

Question 5. Do you agree with our proposal to introduce a new CP requiring issuers to maintain a board skills matrix and make disclosure set out in CP B.1.5? Please provide reasons for your views.

Our Response to Question 5

Yes.

Glass Lewis believes that a board skills matrix can be a valuable tool for assessing a board's mix of skills and experience. Additionally, board skills matrices can help guide the director nomination and succession planning processes. In both cases, we believe disclosure of such is meaningful to shareholders. As such, we believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. It has become a mainstream belief among market participants that having an appropriate mix of certain attributes and areas of expertise on the board — in particular skills, experience, diversity, and independence — is essential to ensure that the board as a whole can satisfactorily perform its oversight duty, have informed opinions on all topics relevant to the company, and effectively advise management on important strategic decisions. A largely homogenous board with skills and experience gaps represents a significant risk. The reduced oversight and increased groupthink that can result from a non-diverse board lacking the requisite skills has been posited as a major cause of corporate scandals and could become a source of competitive disadvantage.

Disclosure of a board skills matrix will help boards undertake an honest self-assessment of their own self-assessment, as well as help shareholders challenge boards that may need an external challenge to do so.

V. Overboarding INED and directors' time commitment

Question 6. In relation to our proposal to introduce a “hard cap” of six listed issuer directorships that INEDs may hold, do you agree:

- (a) With the hard cap to ensure that INEDs are able to devote sufficient time to carry out the work of the listed issuers?
- (b) With the proposed three-year transition period to implement the hard cap?

Please provide reasons for your views.

Our Response to Question 6

Yes, however further room for improvement remains. We believe a hard cap of five listed issuer directorships will be more appropriate.

Glass Lewis believes that directors should have the necessary time to fulfil their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis. While we welcome the implementation of a hard cap to address potential overcommitment, Glass Lewis believes that a director should hold no more than five non-executive directorships concurrently while an executive officer of any public company should not serve on more than one additional external public company board, to ensure they can effectively fulfill their responsibilities.

In our 2023 Client Policy Survey, 89.1% of investors and 92.2% of non-investors responded that all non-executive directors should serve on five boards or fewer, which aligns with Glass Lewis' benchmark policy. Glass Lewis views such overcommitted directors as a risk to companies particularly because directors who are overcommitted may not be able to dedicate sufficient time to the boards on which they serve when one of the companies faces a crisis.

Our approach is intended to reflect the ever-increasing complexity of business environments in which companies operate and the complex nature of the responsibilities of directors, which have also become more demanding. This has resulted in the commitment associated with being a director being on a significant upward trend in the past decade. In addition, we believe a lower threshold is further aligned with regional and global best practice. For instance, Mainland China has recently imposed a hard cap of three concurrent non-executive directorships that an individual can hold. Pursuant to Directive 2013/36/EU of the European Parliament and of the Council), executives of significant financial institutions are prohibited from serving on more than two outside boards, while non-executive directors of significant financial institutions are limited to four outside directorships).

We view the hard cap of six, while an improvement, is still high versus international practice. We suggest a hard cap of five would better serve boards and shareholders.

On the other hand, it may be worth carving out some exceptions for holding companies or non-operating entities for different treatment under the cap. This is as the time commitment for directorships of such entities may be substantially lower than other publicly listed directorships.

In our view, a three-year transition period is reasonable to allow overcommitted directors to reduce their commitment level to align with regulatory requirements.

Question 7. Do you agree with the proposal to introduce a new Mandatory Disclosure Requirements (MDR) to require the nomination committee to annually assess and disclose its assessment of each director's time commitment and contribution to the board? Please provide reasons for your views.

Our Response to Question 7

Yes.

Glass Lewis welcomes enhanced disclosure requirements regarding a nomination committee's assessment of each director's time commitment and contribution to the board.

We agree with the view of the Exchange that time commitments are affected by several factors, such as the number of directorships, the size and context of the entities where directorships are held and the nature, scale and complexity of their activities, as well as other professional or personal commitments and circumstances.

In our 2023 Client Policy Survey over 82% of investor respondents were of the view that board-level responsibilities, such as committee membership and chair roles, should be factored in when assessing commitment levels.

We believe that all boards should be routinely assessing the ability and availability of their members to effectively discharge their duties, which should invariably include an assessment of directors' material external commitments. Accordingly, we welcome the adoption of the disclosure requirement.

(B) Independence of INEDs

Question 8. In relation to our proposal to introduce a “hard cap” of nine years on the tenure of INEDs, beyond which an INED will no longer be considered to be independent, do you agree:

- (a) With the proposed hard cap to strengthen board independence?
- (b) That a person can be re-considered as an INED of the same issuer after a two-year cooling-off period?
- (c) With the proposed three-year transition period in respect of the implementation of the hard cap?

Please provide reasons for your views.

Our Response to Question 8a and 8c

Yes.

Glass Lewis welcomes a tenure limit of nine years, after which point an INED will no longer be considered independent. While we accept that accumulated experience in a company over a substantial period or business cycle may be a valuable resource to a board and investors, we firmly believe that the longer the period of service, the more likely it is that the independence, and possibly also the contribution, of a director will be blunted. And there is the further issue, in today's often fast-changing business environment, whether the long-serving director's particular skillset and experience remain a core competence requirement of the board.

While Glass Lewis currently applies a tenure limit of twelve years, after which point, we no longer consider a director to be independent, such limit was adopted in recognition of the absence of a hard regulatory limit. We believe the nine-year tenure cap would align with regional best practice with numerous APAC markets including Mainland China, Singapore, Pakistan, India, Sri Lanka, Bangladesh, and the Philippines having already enacted caps on independent director tenure which range anywhere between six and ten years.

We agree that a three-year transition period is reasonable for the introduction of the hard cap.

Our Response to Question 8b

No.

While we are in favour of the adoption of the proposed tenure limit, we oppose the adoption of a cooling-off period provision whereby a long serving INED may be considered independent if they rejoin a board after a cooling off period of two years, such provision would effectively ‘reset the clock’ for long tenured directors and would undermine the desired objectives of the tenure cap such as board refreshment, enhanced succession



planning and improved board diversity. Furthermore, a cooling off period of just two years would do little to alleviate shareholder concerns that a long tenured director may have become overly familiar with a company's management to the extent that their objectivity may be compromised.

Question 9. Do you agree with the proposal to require all issuers to disclose the length of tenure of each director in the CG Report? Please provide reasons for your views.

Our Response to Question 9

Yes.

Glass Lewis believes that as a measure of good disclosure, all companies should disclose the tenure of all directors, not just long serving independent non-executive directors. Such disclosure should be included in annual reports and in shareholder meeting circulars as part of the basic disclosure.

(C) Board and workforce diversity

Question 10. Do you agree with our proposal to introduce a CP requiring issuers to have at least one director of a different gender on the nomination committee? Please provide reasons for your views.

Our Response to Question 10

Yes.

We agree with the Exchange's view that improved gender diversity on the nomination committee will facilitate the development of a more diverse talent pipeline within the company. This view is further evidenced by recent research conducted by The Asian Corporate Governance Association (ACGA) which highlighted a correlation between female representation on the nomination committee and improved gender diversity at board level.

Question 11. Do you agree with our proposal to introduce a Listing Rule to require issuers to have and disclose a diversity policy for their workforce (including senior management)? Please provide reasons for your views.

Question 12. Do you agree with our proposal to upgrade from a CP to a MDR the requirement on the annual review of the implementation of an issuer's board diversity policy? Please provide reasons for your views.

Our Response to Question 11 and 12

Yes.

Glass Lewis welcomes an MDR that results in boards reviewing their performance to include the implementation and effectiveness of board diversity policies. In this case, it isn't enough for a board to simply adopt a board diversity policy. As part of its annual review, all boards should consider how diversity is working to enable the board to meet its goals and overall performance.

Question 13. Do you agree with our proposal to require as a revised MDR separate disclosure of the gender ratio of: (i) senior management; and (ii) the workforce (excluding senior management) in the CG Report? Please provide reasons for your views.

Our Response to Question 13

Yes.

We welcome the introduction of an MDR to require separate disclosure of the senior management gender ratio and the workforce gender ratio (excluding senior management). Glass Lewis shares the Exchange's view that diversity at senior management level is a helpful indicator of an issuer's progress on, and commitment to, diversity.

Question 14. Do you agree with our proposal to codify the arrangements during temporary deviations from the requirement for issuers to have directors of different genders on the board as set out in draft MB Rule 13.92(2) in Appendix I? Please provide reasons for your views.

Our Response to Question 14

Yes.

Glass Lewis agree with the proposal to codify the arrangements during temporary deviations from the requirement for issuers to have directors of different genders on the board as set out in draft MB Rule 13.92(2) in Appendix I.

(D) Risk management and internal control

Question 15. Do you agree with our proposal to:

- (a) emphasise in Principle D.2 the board's responsibility for the issuer's risk management and internal controls and for the (at least) annual reviews of the effectiveness of the risk management and internal control systems; and
- (b) upgrade the requirement to conduct (at least) annual reviews of the effectiveness of the issuer's risk management and internal control systems to mandatory and require the disclosures set out in MDR paragraph H?

Please provide reasons for your views.

Question 16. Do you agree with our proposal to refine the existing CPs in section D.2 of the CG Code setting out the scope of the (at least) annual reviews of the risk management and internal control systems? Please provide reasons for your views.

Our Response to Question 15 and 16

Yes.

Glass Lewis relies on publicly disclosed information for its research and as such, we welcome any measure that promotes meaningful reporting on how a company manages risks and safeguards shareholders' interest.

The risk oversight process begins with the board who has the task of overseeing management's implementation of strategic and operational risk management. The presence of a sound risk management programme should demonstrably identify and reduce the frequency of potentially large loss events.

Glass Lewis welcomes proposals for more explicit reporting by boards regarding the effectiveness of risk management and internal control, which we believe will bolster confidence among investors and other stakeholders. Further, we agree that reporting on the performance of risk management and internal control systems reinforces directors' responsibility for these systems. In addition, by requiring that boards declare that they can reasonably attest to the effectiveness of risk management and internal control, director accountability in this area is strengthened – which, in our view is the most effective means of attaining the desired outcomes.

Glass Lewis agree with the proposal to refine the existing CPs in section D.2 of the CG Code setting out the scope of the (at least) annual reviews of the risk management and internal control systems.

(E) Dividends

Question 17. Do you agree with our proposal to introduce a new MDR requiring specific disclosure of the issuer's policy on payment of dividends and the board's dividend decisions during the reporting period? Please provide reasons for your views.

Our Response to Question 17

Yes.

Glass Lewis generally supports management's decision on dividends and in most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend or if shareholders would be better served by forgoing a dividend to conserve resources for future opportunities or needs. That being said, we also believe that enhanced dividend disclosure provides an understanding of the board's considerations in setting the policy, including the rationale for the policy selected. Good disclosure relates the policy to the company's strategy; explains how it will be implemented; and makes clear the associated risks, constraints and judgements. As recognised by the United Kingdom's Financial Reporting Council, this disclosure promotes an understanding of the board's stewardship, including how capital is being maintained (*FRC Insight report: Disclosure of dividends revisited*. June 29, 2023).

High-quality disclosure helps investors assess dividends as a source of consistent and sustainable returns. However, returns are always considered in the context of the wider economic environment, and not just on year-on-year basis. Better disclosure reflects and adjusts to the changing context.

Accordingly, we support the proposal to introduce a new MDR requiring specific disclosure of the issuer's policy on payment of dividends and the board's dividend decisions during the reporting period.

(F) Other minor Rule amendments**I. Requirement for issuers to set a record date**

Question 18. Do you agree with our proposal to introduce a Listing Rule requirement for issuers to set a record date to determine the identity of security holders eligible to attend and vote at a general meeting or to receive entitlements? Please provide reasons for your views.

Our Response to Question 18

Yes.

Glass Lewis supports the proposal to codify existing guidance by revising the Listing Rules to require issuers to set a record date for general meetings and for receiving entitlements. Glass Lewis shares the view that such provisions will provide clarity to securities holders and the market as to when the identity of securities holders is to be determined for the purpose of determining eligibility to participate in relevant corporate events.

II. Disclosure on modified auditors' opinion

Question 19. Do you agree with our proposal to codify our recommended disclosures in respect of issuers' modified auditors' opinions into the Listing Rules? Please provide reasons for your views.

Our Response to Question 19

Yes.

Glass Lewis welcomes the proposal to codify the Exchange's recommended disclosures in respect of issuers' modified auditors' opinions into the Listing Rules. Financial reporting is of critical importance to investors who we believe should be concerned with any type of modified opinion expressed by a Company's auditor, as such matters could potentially prove to dampen shareholder value.

An audit committee performs critical responsibility to provide adequate information and explanation to the auditor for it to be able to conduct proper audit of the Company's accounts. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors.

Accordingly, we support the proposal to codify the existing recommended disclosures into the Listing Rules.

III. Financial information

Question 20. Do you agree with our proposal to clarify our expectation of the provision of monthly updates in CP D.1.2 and the note thereto? Please provide reasons for your views.

Our Response to Question 20

Yes.

Glass Lewis agrees that directors need timely, high-quality information, including an assessment of the issuer's performance, position and prospects, in order to facilitate their thorough consideration of issues prior to, and informed discussions at, board meetings. Accordingly, we support to the proposed clarification to the existing code provision to make it clear that directors are entitled to and should request such information if the management does not provide it.

IV. Align nomination committee requirements with existing audit committee and remuneration committee requirements

Question 21. Do you agree with our proposal to align requirements for the nomination committee, the audit committee and the remuneration committee on establishing written terms of reference for the committee and the arrangements during temporary deviations from requirements as set out in draft Main Board Listing Rules 3.23, 3.27, 3.27B, 3.27C and 8A.28A in Appendix I? Please provide reasons for your views.

Our Response to Question 21

Yes.

Nomination committees are responsible for ensuring that the board contains the right balance of skills, experience, independence and knowledge to effectively oversee the company on shareholders' behalf. This process includes managing the terms and disclosure of board appointments, both in initial recruitment and on an ongoing basis, with an emphasis on progressive refreshment. The committee should also set out the board's policy on diversity, with specific reference to gender and ethnicity, including details of any internal objectives and progress against them. We expect the committee to meet all applicable disclosure requirements, and to take responsibility for board appointments and re-appointments.

Implementation dates and transitional arrangements

Question 22. Do you agree with the proposed implementation date of financial years commencing on or after 1 January 2025, with transitional arrangements 151 as set out in paragraphs 182 to 183 of the Consultation Paper? Please provide reasons for your views.

Our Response to Question 22

Yes.

Glass Lewis agrees with the proposed implementation dates and transitional arrangements. We share the view of the Exchange that boards may need additional time to adjust their board composition and as such, a three-year transition for the proposed hard cap on director tenure and overboarding is reasonable. We agree that for the other proposed amendments an effective date of January 1, 2025 (applying to annual reports with a financial year commencing on or after January 1, 2025) represents a reasonable timeframe for issuers to comply with new regulatory requirements.