Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (response@hkex.com.hk) and post

16 August 2024

Our Ref.: C/CG, M139863

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

Dear Sirs,

Re. Consultation Paper, Review of Corporate Governance Code and Related Listing Rules

After consulting members of our Corporate Finance Committee, Professional Accountants in Business Committee and corporate governance (CG) specialists among our membership, we set out in the Appendix the views of Hong Kong Institute of Certified Public Accountants (the Institute) on the questions contained in the above-referenced consultation paper.

We appreciate the Exchange's efforts in reviewing the Corporate Governance Code and keeping abreast of regulatory changes taking place in other markets. In our view, it is vitally important for the continued success of Hong Kong's markets that high standards of CG, in addition to environmental, social governance (ESG), practices, are upheld and are seen to be maintained among listed companies, as well as major public sector organisations in Hong Kong. The commitment of regulators and other stakeholders to promoting and supporting best practices is equally important and, in this regard, the Institute continues to advocate for and support the development of a strong CG and ESG culture in Hong Kong, through its awards and other projects.

Against the above background, we agree with most of the proposals in the consultation, and the overarching objectives to improve board effectiveness and independence, enhance training for directors of Hong Kong listed companies, and also strengthen corporate diversity, transparency and disclosure. At the same time, we make various suggestions on the details, seek further clarification in some cases and explain our concerns regarding one or two of the proposals.

Should you have any questions on this submission, please feel free to contact me at the Institute on [redacted] or at [redacted].

Yours faithfully,

Encl.

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈三十七樓

Tel 電話 : (852) 2287 7228
Fax 傳真 : (852) 2865 6603

Web 網址 : www.hkicpa.org.hk
E-mail 電郵 : hkicpa@hkicpa.org.hk

Hong Kong Institute of Certified Public Accountants:
Response to HKEX Consultation Paper on Review of Corporate Governance Code and Related Listing Rules (June 2024)

Question 1: Do you agree with our proposal to introduce a new CP requiring issuers without an independent board chair to designate one INED as a Lead INED to enhance engagement with investors and shareholders?

We agree. However, it needs to be made clear whether this is applicable only where a company does not have an independent board chair or more generally. Paragraph ("para.") 25 of the consultation paper ("Paper"), states: "Where an issuer has an independent board chair, the Exchange expects the board chair to fulfil the role of the Lead INED, unless the issuer designates another INED as the Lead INED". So, this implies that all listed companies should have a designated lead INED or someone one fulfilling the functions referred to in para. 27 of the Paper. While we would not disagree with this, the statement of the proposal, in para. 24, which is only that "issuers without an independent board chair should designate one INED as a Lead INED" could be confusing when taken in isolation.

The following could be among the matters covered in proposed guidance for companies on the expected role and functions of a Lead INED (para. 27 of the Paper):

a. Communication mechanisms between shareholders and the board and frequency of meetings/ communications between the Lead INED and shareholders, especially minority shareholders.
b. Compliance and role in relation to critical transactions.
c. How the Lead INED should interact with the three major committee chairs.
d. Role of Lead INED in the board performance review and evaluating the chair's performance
e. Responsibilities in circumstances such as the sudden resignation of the board chair and whether the Lead INED would deputise for the board chair.
f. Disclosure of the Lead INED's and INEDs' work

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?

While we support a mandatory training requirement, based on the Exchange's observations (para. 38 of the Paper), given that the minimum required topics are set out in the proposed Rule 3.09G, it would make sense to specify also a minimum number of hours - say, 5 hours (based on 5 topics). Directors who are members of professional or industry bodies with mandatory continuing professional development ("CPD") requirements for members should be able to count CPD covering the relevant topics, as meeting the Listing Rule requirement.

(b) Require First-time Directors to complete a minimum of 24 hours of training within 18 months following their appointment?

In principle, we agree. However, the figures seem somewhat arbitrary. For example, should a First-time director not complete mandatory training within in the first year of becoming a director, or at least complete a minimum of 12 hours within the first year?

In addition, we would not agree entirely with the proposal in para. 43 of the Paper to re-reset the calculator if a First-time Director ceases to be director and is subsequently appointed director of another company (or the same) company listed on the Exchange. If the new appointment is made within, say, one year of ceasing to be director, and the individual involved has already undertaken more than a minimal amount of the required training, that previous training should be taken into account. For example, it would appear to be superfluous, and unduly onerous, for a person who has already undertaken more than 15 hours of training within the first 15 months

of appointment to, in effect, have to redo that if he/she ceases to be director and then takes up a new appointment as a director of a Hong Kong-listed company within a few months.

With reference to the point made in the response to (a), above, First-time Directors who are members of professional or industry bodies with CPD requirements for members should also be able to count CPD covering relevant topics, as meeting the Listing Rule requirement.

(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?

Generally, yes, but it may be better to refer to, e.g., "First-time Hong Kong/ HK Directors", as this may be less confusing given that the individuals concerned may also be directors of companies listed on other exchanges. That said, we have reservations about requiring directors appointed for the first time as a director of a company listed on the Hong Kong Stock Exchange, having to meet the requirement in full, where they are directors of a company or companies listed on other exchanges, who can establish that they have undergone similar training on those other exchanges within the past three years, particularly if those other exchanges also have a mandatory training requirement.

(d) Specify the specific topics that must be covered under the continuous professional development requirement?

We agree. The proposed specific areas of training are core areas of knowledge that should be covered. To further board effectiveness, other possible mandatory topics could include updates on the latest developments in professional knowledge and skills that facilitate board decision-making processes, such as valuation and cybersecurity.

<u>Question 3</u>: Do you agree with the proposed consequential changes to Principle C.1 and CP C.1.1 of the CG Code?

Generally, yes, but regarding the reference in the proposed CP C.1.1 to the company being "responsible for arranging and (where necessary) funding" directors' training, the Exchange's intention should be made clearer. While requiring companies to arrange and fund induction training for newly-appointed directors is reasonable, it is more questionable whether it should it be the company's responsibility to arrange and fund ongoing training. To use the analogy of professionals who are members of professional bodies, while they generally have a requirement to undertake a certain amount of CPD hours annually, and their professional bodies will normally arrange a CPD programme, which may or may not be sufficient in itself to meet that requirement, it is the responsibility of the individual to ensure that they undertake in the requisite CPD and to pay for it. If the responsibility is put entirely on the company to arrange ongoing director training, then it may be easier for directors who are facing disciplinary cases and demonstrate ignorance of the rules, to put the blame on the company for not arranging and/or funding adequate or appropriate training. Some onus should be put on directors, post induction to ensure that they undertake adequate training. There should be, at least, a shared responsibility, and, arguably, funding of training is something that should be considered in the context of setting directors' remuneration.

<u>Question 4</u>: Do you agree with our proposal to upgrade the current 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.

We agree, in principle, for the reasons explained in the Paper. We note from para. 65 of the Paper that the Exchange will provide more guidance on the areas to be covered. This will be important, to ensure that any review is focused, and to reduce the risk that this requirement will be seen simply as a compliance matter, which would add little value to either genuine board effectiveness or the quality of reporting.

It is advisable to include an explanation of the importance of any gap year between each review. For example, the board can use the gap year to assess priority areas in board performance and/or desired performance objectives for the next performance review, thereby improving the value of each review.

For the disclosure requirements, companies should be encouraged to formulate a table listing the strengths and weaknesses identified in the review, which can provide a more comprehensive view of the overall board performance. Additionally, the methodologies used in conducting the review should also be disclosed, such as face-to-face interviews, questionnaires, and observations of boardroom processes. This can further enhance the transparency and reliability of the review and its results.

In the long run, to support board effectiveness, INED remuneration levels should be benchmarked against industry peers and practices across different jurisdictions.

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?

We agree that companies' disclosures generally do not indicate how the combination of skills and qualifications, experience and diversity of their directors helps to serve or contribute to the purpose, values, strategy, and desired culture of the company, and that such information should be relevant when considering appointments to the board.

It is suggested that the basis for concluding that directors possess the relevant skills also be disclosed in the skills matrix. For example, this can be demonstrated by their obtaining certificates and/or qualifications issued by professional institutes or by gaining relevant hands-on experience.

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?

Broadly, yes. While this does not provide any guarantees, sitting on six listed company boards already means attending and preparing for a minimum of 24 board meetings annually, assuming the companies concerned comply with CP C.5.1, to hold at least four meetings per year. Bearing in mind that this is the minimum number of board meetings and that INEDs will almost certainly be expected to sit on other board committees, such as the audit, remuneration and nomination committees, it is difficult to see how a director can devote sufficient time to the individual boards if he/she has even more listed company commitments than this.

Furthermore Listing Rule 3.08 states, inter alia: "Directors must satisfy the required levels of skill, care and diligence. Delegating their functions is permissible but does not absolve them from their responsibilities or from applying the required levels of skill, care and diligence. Directors do not satisfy these required levels if they pay attention to the issuer's affairs only at formal meetings. At a minimum, they must take an active interest in the issuer's affairs and obtain a general understanding of its business. They must follow up anything untoward that comes to their attention." This, again, emphasises that directors cannot discharge their duties simply by attending meetings and, therefore, that a greater time commitment is essential.

Notwithstanding the above, it has been suggested that there may be scope for slightly more flexibility where an INED is sitting on boards with different year ends. The Exchange may wish to consider this point further.

(b) With the proposed three-year transition period to implement the hard cap?

We agree.

Question 7: Do you agree with the proposal to introduce a new MDR to require the nomination committee to annually assess and disclose its assessment of each director's time commitment and contribution to the board?

We agree. This will encourage prospective directors and listed companies seeking to appoint them, to consider seriously whether prospective candidates for the board and existing board members really have sufficient time to devote to a directorship. In addition to appointments to Hong Kong listed company boards, the number of which is it proposed to limit, appointments to governing boards of significant public sector bodies, non-government organisations and charities, etc., as well as boards of companies listed on other exchanges, can also involve a considerable time commitment.

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?

In principle, we agree with introducing a cap. However, some of the specifics could be considered further. In view of the number of long-serving INEDs serving on the boards of listed companies in Hong Kong (covering around 31% of all listed issuers, according to para. 100 of the Paper, although what proportion of directors overall are long serving is not clear), and given that such term limits are often in the form of guidance on other markets (e.g., United Kingdom and Australia), and, it also would seem, in the case of the Hong Kong Monetary Authority in respect of INEDs on bank boards in Hong Kong, it might be better to take more incremental approach. One option would be to introduce the cap as a CP in the first instance, with the continuation of the existing requirements on re-election beyond nine years, and, bearing in mind the comments in para. 101 of the Paper, a requirement to disclose in the CG Report information on the process or discussion undertaken by the nomination committee and board to determine that a Long Serving INED continues to be independent, where there is a deviation from the CP.

However, we would suggest that a gap of one year or more in which an INED ceases to be an INED (rather than two or more years, as suggested in para. 106 of the Paper) should not be counted toward the cap period, unless the Exchange has good reason to believe that this could be abused, e.g., by allowing continued extensions to the term of a long-serving director.

(b) That a person can be re-considered as an INED of the same issuer after a two-year cooling-off period?

This seems a bit short for a "cooling off" period, if the aim is to encourage more effective board refreshment in the longer term. It might also give companies and investors the impression that the replacement of long-serving INEDs could be just a temporary, stop gap arrangement, as those individuals could be brought back onto the board after a relatively short period and the clock would re-set. Under the circumstances, a three-year cooling off period might be more appropriate.

(c) With the proposed three-year transition period in respect of the implementation of the hard cap?

We would agree, given the number of long-serving directors still on the boards. However, if the cap is introduced as a CP in the first instance, as suggested in our response to Question 8(a), this may be less of an issue.

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?

We agree. This will allow stakeholders to understand and monitor the situation much more easily.

<u>Question 10</u>: 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?

Given all the other existing and proposed requirements around board diversity (e.g., Main Board Rule 13.92/ GEM Rule 17.104, Code MDR J, CP B.1.3, etc.), and that it does not appear to be a common requirement elsewhere, we are not totally convinced of the need for this. Furthermore, in some cases, it could be an undesirable imposition on female board members. Where there is only one female director on the board, that director may, for example, be an accountant whose skill set and preferences would make her more suitable to sit on the audit committee, remuneration committee, and/or risk committee, etc. That director may have no particular desire to join the nomination committee, or insufficient time to join the nomination committee as well as her preferred committees.

Another scenario may be where the only female board member is a family member in a family-controlled business. By, in effect, requiring the board to put that director on the nomination committee, this may strengthen the committee's diversity, while, at same time, weakening its independence.

<u>Question 11</u>: 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)?

We agree. This will encourage listed companies to think about diversity from a more strategic perspective and not merely as an issue of board composition.

<u>Question 12</u>: 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?

We agree. This will make relevant information more transparent and companies' more accountable in terms of their diversity policies and initiatives.

<u>Question 13</u>: 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?

We agree. This will make relevant information more transparent and companies' more accountable in terms of their diversity policies and initiatives.

<u>Question 14</u>: 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?

We agree. This is similar to the arrangements in place for companies to disclose and address temporary deviations from the requirement for a minimum number INEDs on the board, which is appropriate in the circumstances.

<u>Question 15</u>: 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?

We agree, for the reasons explained in the Paper. We have also found in the context of the reviewing annual report disclosures for the Institute's Best Corporate Governance and ESG Awards, that many companies' disclosures regarding their risk management and internal control ("RMIC") system, and reviews undertaken of their RMIC system, contain insufficient information to make a meaningful

assessment of what has been done and to give assurance as to whether the RMIC system is really working effectively.

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?

We do not agree. Generally, we find the proposed change in wording to be confusing. The proposed revised wording of Code Provision (CP) D.2.1 appears to mix up the scope of the review and issues that the directors should consider for the purposes of conducting the review. For example, the existing CPs D.2.2 and D.2.3 indicate specific areas that the annual review of the RMIC system should cover, while the proposed refined wording states that the board should consider such issues for the purposes of the review. The intention of this subtle change in wording not clear. However, it appears to draw a distinction between the board's consideration and the review itself, based on the wording of the first item, i.e.:

"D.2.1. …..the board should consider:

(a) the scope of the review to ensure it covers all material controls, including financial, operational and compliance controls"

More particularly, we are very concerned by the proposal to change the wording of the existing CP D.2.2, which includes, within of the scope of the RMIC review, consideration of "the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's accounting, internal audit, and financial reporting functions, as well as those relating to the issuer's ESG performance and reporting."

The proposed revised wording, on the other hand, refers to the board being required to consider "the adequacy of resources (internal and external) for conducting the review, including staff qualifications and experience, training programmes and budget of the issuer's accounting, internal audit, and financial reporting functions..." [underlining added]. This would change the requirement from one for the review to consider whether those functions are adequately resourced, generally (i.e., are fit for purpose) to a requirement to consider whether the resources of those functions are adequate for conducting the review of the RMIC systems, which is a completely different and much more limited requirement.

The wording and meaning of the existing CP D2.2 are very clear. It is not explained in the Paper why there is any need to change the CP and we do not see any need to do so. It may just be matter of ambiguous drafting, however, prima facie, this is not merely a refinement, but, conceptually, something completely different. If this is intended, we would disagree strongly with the proposal. The existing wording was introduced as an important CG safeguard in 2009, when the requirement in the Listing Rules for issuers to engage a "qualified accountant ('QA')" was removed, despite objections on CG grounds from a substantial proportion of respondents. Prior its removal in 2009, Main Board Listing Rule ("MBLR") 3.24, introduced in March 2004, stated:

"*Every listed issuer must ensure that, at all times, it employs an individual on a full time-basis. The responsibility of such individual must include oversight of the issuer and its subsidiaries in connection with its financial reporting procedures and internal controls and compliance with the requirements under the Exchange Listing Rules with regard to financial reporting and other accounting-related issues. The individual must be a member of the senior management of the listed issuer (preferably an executive director) and must be a qualified accountant and a fellow or associate member of the Hong Kong Society of Accountants [later renamed as the Hong Kong Institute of Certified Public Accountants] or a similar body of accountants recognised by that Society for the purpose of granting exemptions from the examination requirement for membership of that Society*."

We believe that, nowadays, there are even stronger grounds for a QA requirement than there were in 2004, when the rule was introduced into the MBLRs (or, in 1999, when a similar requirement was first

introduced into the GEMLRs), which is why we are advocating for a new QA requirement in the MBLRs/ GEMLRs. A contemporary QA's responsibilities would extend beyond financial reporting and accounting procedures and internal controls. It should encompass oversight of ESG reporting, particularly the financial aspects (and, with the adoption of international sustainability disclosure standards, increased integration of financial and ESG reporting), as well as areas such as anti-money laundering/ counter-terrorist financing controls, tax governance and risk management more generally.

Given the above, it would be a highly retrograde step to alter the wording of CP D.2.2 as proposed in the Paper.

We recommend, therefore, that the drafting of this proposal and, potentially, the substance of the proposal itself, need be looked at again, to clarify what the review of the RMIC system should cover and the board's specific role in this process.

Furthermore, we would suggest that the opportunity of this CG review be taken to consider seriously the introduction of a new requirement for a QA. We would be happy to further elaborate on the rationale and the perceived need for such a requirement.

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?

We agree, for the reasons set out in the Paper. Listed companies' dividend policy is a very important aspect of performance for investors and there has long been a lack of transparency around this area. Therefore the proposal to enhance transparency will be welcomed by investors and other stakeholders.

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?

We agree, for the reasons set out in the Paper. This will enhance transparency and certainty.

Question 19: Do you agree with our proposal to codify our recommended disclosures in respect of issuers' modified auditors' opinions into the Listing Rules?

We agree. This will enhance transparency. At the same time, regarding the proposed amendments to Appendix D2, Disclosure of Financial Information, is it the intention that para. 3.1(b), should apply only to issues of judgement, or should it be framed more generally, so as to cover other situations as well, e.g., where the auditors are unable to obtain supporting document / sufficient appropriate evidence?

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.

We agree that relevant and appropriate monthly information should be provided to the board and each director, and that they should be entitled to receive this. However, the proposed CP also states that the board and each director should request this information, which may give the impression that the necessary information may not be provided as a matter of course, and perhaps only upon request. The CP should instead state that the information should be provided, and that the board and each director may request additional information as may reasonably be required to enable the board as a whole and each director to discharge their duties under Rule 3.08 and Chapter 13.

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?

We agree, as this will ensure consistency in requirements and arrangements applicable across the key board committees.

Question 22: Do you agree with the proposed implementation date of financial years commencing on or after 1 January 2025, with transitional arrangements as set out in paragraphs 182 to 183 of the Consultation Paper?

We agree.

Hong Kong Institute of CPAs
August 2024