16 August 2024

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

By email: [redacted]

Re: Consultation Paper on the Review of CG Code and Related Listing Rules

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 102 member firms, of which 80% are institutional investors with more than US$40 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 major proposals relating to board effectiveness, independence and diversity. We then discuss other proposals that we believe will enhance corporate governance practices and disclosure in Hong Kong. We also highlight related issues and bolder measures which have not made it onto the reform agenda.

HIGH-LEVEL COMMENT

ACGA broadly agrees with the five goals that frame the consultation paper as well as its key proposals and commends HKEX for taking the initiative to advance governance in these areas. However, we believe there is room for further improvement and set out below where these proposals could go further and follow international best practice.

One key aspect is the independence of directors. Two high-profile cases of corporate collapse in recent years—China Evergrande and Country Garden—underscore the dangers of not having genuine independence on the board. Both companies' independent directors (INED) were excessively tenured,[1] classified as independent even though they had served for up to 13 and 16 years, while one of Country Garden's INEDs sat on the boards of 17 other listed companies, including posts as executive chair and non-executive chairman. The lack of independence and the resulting ineffectual boards is not coincidentally a central feature of both companies' collapse.

To reinforce investor confidence, ACGA recommends bolder steps. In particular:

- **A vote of minority shareholders on INEDs**. HKEX briefly mentions in the consultation paper that many listed companies are family-controlled (p8). In Hong Kong, it is still common for a controlling shareholder

[1] China Evergrande had three INEDs who served for 10 years or more: two had been directors for 13 years. Four out of five Country Garden INEDs held these posts for more than a decade, with three serving for 16 years, according to both companies' 2022 annual reports.

to both nominate and effectively elect INEDs, leaving minority investors with little more than the opportunity of a protest vote. Too many INEDs are patently not independent. We recommend a vote of independent shareholders for the election of INEDs which would greatly enhance the legitimacy of such directors in the eyes of the minority and foster greater trust. We also believe that most independent shareholders would support any qualified and experienced INED candidates who have been put forward through a thoughtful and well-organised nomination process. If an INED does not receive minority support, then they should be required to re-stand for election at the next AGM. The company should provide an explanation as to why the director should continue to serve on the board.

- **Independence of NC Chair:** We would like to take this opportunity to reiterate our concern that NCs can still be chaired by the board chairman, usually a connected person. In the 2021 consultation on the Code and Listing Rules, HKEX modified a proposal to allow the NC to be chaired by the board chairman, citing suggestions to "retain current flexibility". We believe this is a missed opportunity. Hong Kong lags the region in this respect: Australia, Malaysia, Singapore, Thailand and India all require the NC chair to be independent.

The following points are issues not covered in the consultation, or not given due emphasis in our view, that we would like to highlight:

- **Facilitating more dialogue between INEDs and shareholders.** There is a growing demand from global investors to engage with INEDs. We recommend that INEDs who chair the board committees be accessible to shareholders, regardless of whether they are Lead INEDs or there is an independent chair. They can play an important role in explaining the board's considerations on matters such as executive remuneration and succession, not via Investor Relations representing management. As one ACGA member comments, "it is an illusion to have the access we want through Investor Relations".

- **Strengthening internal audit.** The role of internal audit receives less attention than it deserves in the current consultation. Internal audit not only provides assurance but also offers advice and insights on risk management and internal controls. We recommend upgrading the code provision on the establishment of an internal audit department to a listing rule. India, Malaysia, and Indonesia have already mandated that their listed companies do so.

- **Updating the minimum three/one-third rule on INEDs.** This outdated standard once again sets Hong Kong well behind the curve on corporate governance. As we advocated in our December 2017 and June 2021 submissions, ACGA recommends that this should be upgraded to half or a majority of INEDs.

MAJOR PROPOSALS

We particularly welcome the following proposed revisions to the CG Code and Listing Rules:

(A) I. Designation of Lead INED: We welcome the introduction of the Lead INED concept, which would bring Hong Kong in line with the UK, Singapore, Australia and Malaysia. ACGA advocated for it in the submissions to HKEX in 2017 and 2021 regarding the revisions of the CG code and Listing Rules.

As noted in the consultation paper, nearly one in four listed companies have an overlapping board chair and CEO. A larger number of issuers have separate roles for chair and CEO but do not have an independent board chair. Having a Lead INED on the board provides a counterbalance to the chair who generally is not independent on the boards of Hong Kong-listed companies.

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HKEX also identifies “a lack of access to the board, in particular its INEDs” as a major concern for investors. Indeed, global investors subject to stewardship codes and active ownership policies are increasingly seeking dialogue with the board, especially with INEDs. The Lead INED concept is an efficient way to address such demands.

C.1.7 requires a Lead INED to “be available to other directors and shareholders where normal communication channels with the chairman or management are inadequate”. Given the need for investor interaction with independent directors to have a better sense of the workings of the board, ACGA believes that a Lead INED should serve as an available point of liaison for shareholders generally. This would enable direct communication between directors and investors unfiltered by management, with the views of investors thus available to the board in its discussions. We recommend that Lead INEDs publish an account of how the board has ensured best practices and value creation on behalf of shareholders in the annual report. For companies with controlling shareholders, this would provide a greater sense of accountability on the part of INEDs on the board.

The proposal envisages the key role of a Lead INED to facilitate stronger communication between INEDs, the board, and shareholders. We recommend that the Exchange broaden the mandate for Lead INEDs to include situations where the board chair faces conflicts of interest. Australia, Singapore and Malaysia all recognise the important role a senior or lead INED plays in other areas of corporate governance when the chair is conflicted, such as assessing the chair’s performance and succession planning.

Introducing the provision on a comply-or-explain basis is a positive first step. Going forward, we hope HKEX keeps the investing public informed about the frequency of such appointments among listed companies without an independent chair. Over time it would be beneficial to upgrade the provision to a mandatory disclosure requirement, if not a listing rule, for companies that do not adopt Lead INEDs.

We **agree** with the Exchange’s proposal in Question 1 but feel it could go further. While this rule is being introduced on a comply-or-explain basis, we recommend that HKEX provide strong guidance that larger companies in the market are expected to have a Lead INED where the chair is not independent to facilitate discussions with the stewardship teams of their minority shareholders.

(A) V. Overboarding INED and directors’ time commitment: A hard cap on the number of INED directorships is welcome, and ACGA notes that the figure of six proposed by HKEX is in line with the Hong Kong Government’s guideline on serving on advisory and statutory bodies for a non-official number.

Still, this figure is generous in the regional context. Malaysia has a limit of five directorships, while in Taiwan the cap on concurrent INED directorships is four and in China, three. Additionally, we need to take into account the reality that many INEDs are in a full-time or demanding position in another company. HKEX itself notes in the consultation that a full-time executive director under the UK CG Code should not hold more than one non-executive directorship in a FTSE 100 company or other significant commitments. We recommend accepting a maximum of four or five directorships, and counting the role of chair or CEO as two directorships given the extra complexity, oversight and time commitment it entails. Indeed, we advocated for the same in our 2011 and 2017 submissions. The increasing complexity in the role of INEDs, the greater responsibilities and legal liabilities, and the geographic and operational complexity of listed companies, argue against setting a higher number. Even four or five directorships is a significant time commitment, and this does not take into account positions INEDs may hold at unlisted companies, charities or non-governmental organisations.

A limit of four or five directorships is also in line with guidelines set by global institutional investors. For example, the California Public Employees' Retirement System (CalPERS) sets the limit at four; both Norges Bank Investment Management (NBIM) and HSBC Asset Management have a cap of five.

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On the issue of mandatory disclosure by the nomination committee (NC) of directors' time commitments, we have doubts about the practical impact of this measure unless issuers are required to be specific on the full range of time demands faced by directors. ACGA is wary of self-confirming, boilerplate reporting from issuers: the risk is that companies may simply state that time and contribution are being managed in a general sense, without providing a qualitative analysis of how this is being achieved.

We know that some NCs do not meet as frequently as investors would expect, and some are chaired by a non-independent board chairman. In the latter case, this may not be conducive to open and unbiased appraisal on the time management of individual directors—this provides a compelling argument for full and frank disclosure on INEDs' offices, appointments and time commitments, rather than an appraised summary.

We recommend that issuers be required to disclose the time commitments they consider appropriate for INEDs and the independent chair. The time commitment of each INED should be specified in the on-boarding letter and disclosed to shareholders. This will enable investors to better gauge whether an INED is overboarded.

Furthermore, a minor change to the language of code provision C.1.5 (now C.1.4) would require directors to disclose to *issuers* the number and nature of offices held in public companies or organisations, and other significant external time commitments. As we have said previously, all directorial positions, not merely those on listed company boards, should be disclosed to shareholders, not just to the issuer.

With the caveats above, we **agree** with the Exchange's proposals in Questions 6 and 7.

(B) Independence of INEDs: We support in principle a hard limit of nine years for INED tenure which is in line with the Hong Kong Monetary Authority's guidance for INEDs of authorised institutions in Hong Kong. However, we disagree with the proposal for a cooling-off period. We consider that an INED can no longer be deemed independent after nine years. A cooling off period could undermine the effectiveness of INEDs and raise particular concerns in a close-knit business community such as Hong Kong where family business culture is strong and affiliated relationships and loyalties are common. We would also recommend that the tenure of the INED include his/her directorships for all related companies of the group, not just the specific company on which he/she has most recently been an INED.

Issuers in the past have voiced concerns that a tenure limit may result in the departure of highly qualified directors and have cited the challenge of recruiting new directors. It is worth noting that a long-tenured INED who is still contributing positively could be redesignated as a non-executive director while the company benefits from a refreshed board with the appointment of new INEDs. Hong Kong as a sophisticated capital market has an ample pool of experienced professionals, while government talent initiatives draw high-calibre candidates to Hong Kong.

We **agree** with the Exchange's proposals in Questions 8(a), (c), and 9, but **do not agree** with the proposal in Question 8(b).

(C) Board and workforce diversity: A new code provision requiring issuers to appoint a female director on the NC would set a new bar in the region and has our full support. The Exchange could consider taking this measure further by recommending that issuers have a female director chair the NC. ACGA's own research shows that having a woman chair the NC leads to greater female representation on boards among the top 100 issuers in Hong Kong and China.

Another new rule requiring mandatory disclosure of how diversity policies are being implemented is also welcome. HKEX itself notes in the consultation that there is "room for improvement in terms of the disclosure of numerical targets and timelines for achieving board diversity''. We found in our CG Watch 2023 survey of 12 Asia

Pacific markets that even large issuers tend to provide generic statements of their diversity policies rather than tangible plans of action. This mandatory disclosure requirement will help focus listed companies on the issue.

We broadly support the mandatory disclosure requirement for gender ratios at all levels of the workforce. As we argued back in 2017, any credible diversity policy should encompass not only board diversity but also diversity within the workforce and management team. One of the impediments to gender balance on boards is a sufficient pool of "board ready" female executives. Looking forward, we recommend that the Exchange require issuers to disclose their plans for providing board-preparation training to middle and senior managers. This will help issuers develop "a more diverse pipeline of talent" as envisaged in the consultation paper (p4).

HKEX amended its Listing Rules in 2022 to eliminate single-gender boards by 31 December 2024. ACGA supports the proposal to require the appointment of a female director to the board within three months where there is none. We would like to see more clarity on the consequences for listed companies that fail to do so. Additionally, we recommend that the Exchange set a firm quota of 30% women on boards with an implementation timeframe of four years.

We **agree** with the Exchange's proposals in Questions 10, 11, 12, 13, and 14.

OTHER PROPOSALS

ACGA also welcomes the following proposed revisions to the CG Code and Listing Rules; however we believe in various aspects they could go further. The points are numbered in accordance with the consultation paper:

(A) II. Mandatory director training: We welcome the emphasis on upgrading directors' knowledge and skillsets and broadly support mandatory training for directors. This would put Hong Kong along with Singapore and Taiwan as one of the few markets in the region requiring prescribed instruction. While new directors (ie, "first-time directors") appointed after 1 January 2025 would have to undergo 24 hours of training within one and a half years of their appointment, there is no requirement on training hours for existing directors. ACGA notes HKEX's observations that disciplinary cases often arise due to directors' lack of knowledge regarding their duties, responsibilities and Listing Rule requirements. It makes sense to set a minimum number of training hours required for existing directors. Taiwan made director training mandatory in its CG roadmap in August 2020, and the following year the Taiwan Stock Exchange (TWSE) advised a minimum of 12 hours for new directors within the first year of appointment and six hours annually for existing directors. We encourage the Exchange to exceed the Taiwan example by requiring existing directors to complete 10 hours of training per year. This would equate to 50 minutes of training per month and is still below the 15 hours required for certain professionals under the CPD programme in Hong Kong.

The revised mandatory reporting rule is welcome, but there is no requirement on the format of training and training providers. We recommend a mix of formal training by professional/educational bodies and in-house company briefings. The training content should be tailored to the needs of directors and their companies, and should include topics such as how to be an effective board member, how to chair a board or committee meeting, how to communicate with shareholders and stakeholders and how to manage ESG and political risks. We do not believe that giving speeches, participating in seminars, writing articles and reading magazines or journals should be classified as "training". We recommend that the Exchange narrow the requisite training formats to more formal and structured ones. Otherwise, this exercise risks being trivialised and subject to abuse. One way for directors to develop "relevant competencies and awareness" (p4) is to regularly meet with investors to gain fresh knowledge and different perspectives.

We **agree** with the Exchange's proposals in Questions 2 and 3, but believe this exercise needs to go further to cover a quantum of required training hours for existing directors as well.

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(A) III. Board performance review: We broadly support upgrading the requirement for a board evaluation to be conducted at least every two years from the current recommended best practice to a code provision. We agree that regular board evaluations are "an important tool" for improving board effectiveness. However, we question the value of limiting the exercise to the board as a whole, rather than individual directors. Markets such as India and Taiwan mandate annual evaluations of the board, board committees and individual directors.

Moreover, we feel that the proposal gives wide discretion as to the format of "formal" evaluations. As HKEX notes, the UK goes a step further in requiring the board chair to consider regular external evaluations. In the case of larger companies, these should take place at least every three years. We recommend that external evaluations be conducted by independent third parties on the board, board committees, and individual directors.

We appreciate the Exchange's goal of improving "transparency to the market" through enhanced disclosure on board reviews. We see great value in providing shareholders with details on the evaluation process, the results and recommendations for improvement. All too often listed companies simply disclose the fact that there has been a board evaluation, and that the board has passed with flying colours. What is lacking are details on whether the evaluation was conducted internally or externally, the process involved, the results, and where areas for improvement have been identified. A summary of recommendations from both internal and external board reviews should be made public. We would also hope that HKEX provides detailed guidelines on areas to be covered in a performance review and what it would consider to be adequate disclosure.

We **agree** with the Exchange's proposals in Question 4, but believe they could go much further in particular to disclose to all shareholders the recommendations arising from board evaluation exercises.

(A) IV. Board skills matrix: A proposed code provision would require companies to have and disclose a board skills matrix in the CG report, with enhanced disclosure on existing skills, how the combination of these as well as experience and diversity of directors serves the purpose and strategy of the company, and plans to acquire further skills. This is a welcome move, as is HKEX's comment in the consultation that it discourages lists of qualifications and experience in the matrix.

ACGA recommends that issuers be encouraged to provide more details on the exact skills directors bring to the board: simply stating these in broad terms ('legal, accounting, commerce') is all too common. There should be detailed articulation of directors' relevant skills, why they are important for the company, and how they support the company's mid-term business strategy.

Additionally, the skills matrix for independent (INEDs) and non-executive directors (NEDs) should be separate from that for executive directors (EDs). This will help investors assess the board's capacity to exercise effective oversight over management. It is also important for issuers to identify and disclose the core industry skills required for directors, as well as any notable gaps based on the nature of the business and risk profile of the company. One particular area to highlight is climate risk.

We **agree** with the Exchange's proposal in Question 5, but believe the skill matrix of INEDs and NEDs should be shown separately from the EDs on a listed company's board.

(D) Risk management and internal control: This measure involves upgrading an annual review of risk management and internal control systems (RMIC systems) to mandatory disclosure and broadening the scope of the review slightly to include remedial measures taken to address control failings and weaknesses. The board under the proposed amendments would be responsible for evaluating and approving the overall risk appetite, reviewing the adequacy of the RMIC systems, overseeing management in risk management, and issuing a statement on the effectiveness of the systems.

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ACGA broadly supports the proposal and would recommend greater emphasis on the respective roles of management and internal audit in implementing and reviewing RMIC systems. The duties of management are only briefly mentioned in the revised CG Code as designing, implementing, and monitoring the RMIC systems; and providing confirmation on the effectiveness of these systems. In practice, management is responsible for implementing the RMIC systems, and has a better understanding of the range of risks an issuer faces daily. Similarly, internal audit's review of the adequacy of an issuer's RMIC system only gets a brief mention. The reporting lines for internal audit remain unclear, particularly when the audit and risk committees coexist.

The new disclosure requirement would see issuers provide information supporting the board's conclusion on the effectiveness of RMIC systems, including "any confirmations received (as applicable)" from internal and external parties. This leaves it to the company's discretion. China requires listed companies to provide an externally audited report on internal controls relating to financial reporting. We recommend that external confirmation be required in key areas of risk management and internal controls.

ACGA would recommend that greater emphasis be placed on effective whistleblowing mechanisms that should be in place and known to staff with comfort provided to potential whistleblowers. The board should oversee the whistleblowing process and ensure that relevant and serious complaints reach the board for review. This is a key element to reduce potential risk and should be a robust safeguard in any listed company.

We **agree** with the Exchange's proposals in Questions 15 and 16 and are of the opinion that they could go further and in particular that greater emphasis should be placed on ensuring a robust whistleblowing mechanism is in place for each listed company.

(E) Dividends: We support in principle the introduction of a new mandatory disclosure rule requiring listed companies to disclose more details on dividend policies and decisions. This measure is a potential response to a regional drive for better capital management: Hong Kong lags the UK, US and China in requiring a dividend policy. We believe that to address capital management issues seriously, HKEX should consider taking the proposal a step further by making it a listing rule. As we recommended in 2017, the disclosure requirement should be broadened to include share buyback and capital allocation policies more generally.

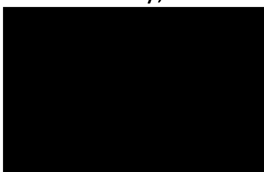
We **agree** with the Exchange's proposal in Question 17 and recommend that this should have the force of a listing rule.

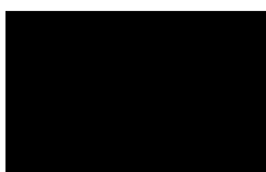
(F) III. Financial information: We broadly support the proposal to clarify the information which should be provided to the board in the monthly updates. We recommend HKEX widen the requirement beyond monthly management accounts and updates to include information relevant to financial performance and any perceived risk in general.

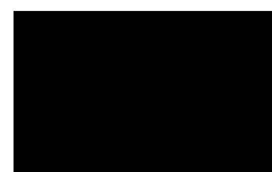
We **agree** with the Exchange's proposal in Question 20 and are of the view it could go further to include other information relevant for the attention of the board.

We appreciate the opportunity to respond to the consultation and would be pleased to discuss any of the points above in more detail. Thank you.

Yours truly,







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