

Our Ref
Your Ref
Direct Tel
Direct Fax
E-Mail

[REDACTED]
[REDACTED]

Date 15th December 2017



Ms. Katherine Ng
Senior Vice President
Head of Policy, Listing Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

One Coleman Street
London
EC2R 5AA
Tel: +44 (0)20 3124 3000

Email: [REDACTED] / response@hkex.com.hk

Dear Ms. Ng,

HKEX Consultation Paper

REVIEW OF THE CORPORATE GOVERNANCE CODE AND RELATED LISTING RULES

Legal & General Investment Management (LGIM) is one of the largest international investors globally with over £957 billion of assets under management (as at 30 June 2017). We manage assets for a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

Over the past 40 years, LGIM has built a business through understanding what matters most to clients (both institutional and retail) and transforming this insight in to valuable, accessible investment products and solutions. This enables pension funds to meet their key long-term financial objective of ensuring fund assets match future financial liabilities and pay pensions.

In Hong Kong, LGIM is a significant investor with over USD 4.1 billion of equity invested in the region both in index and active funds. Furthermore, we have a growing presence in Hong Kong demonstrated by the recent expansion of our trading and index fund management arm. Our strategic commitment is long term.

As a significant investor, there is a responsibility to ensure that global markets operate efficiently and uphold the highest level of governance standards to protect the integrity of the market over the long term. Therefore, the opportunity to respond to the consultation by the HKEX regarding the Corporate Governance Code is very important to LGIM.

A sound corporate governance framework is in the long-term interests of all participants in the Hong Kong market. A robust and understandable governance structure supports issuers and their boards, provides appropriate transparency and protections for investors and shapes a long-term and sustainable premium market.

In Appendix A we have set out our responses to the specific questions in the consultation where we have a strong view or opinion.

In addition to the specific questions set out in the consultation, we strongly encourage HKEX to consider a further consultation of other aspects of the code that we believe are critical to supporting the Hong Kong market and alignment with international investors' expectations.

Narrative Reporting

Good transparency on the activities of a business and its associated risks are important in order to understand its impact on the company. LGIM values meaningful commentary and encourages companies to move away from boiler plate 'generic description' of risks.

We would welcome additional emphasis on bespoke reporting, in particular on areas that will help investors gain an understanding of the development, performance, risks and financial position of the company's business and how the governance of the company is aligned to support these objectives.

Board composition and effectiveness

- *Separation of joint Chairman/CEO position*

We note that combining the roles of chair and CEO is common in Hong Kong. LGIM expect companies to consider the separation of these roles and the appointment of an independent non-executive chairman. This ensures that power on the board is not concentrated in the hands of one individual. Where the position is combined, we expect a robust explanation from the board as to how such a structure is in the best interests of shareholders, including how the board will ensure appropriate accountability and future plans to separate the roles.

- *Appointment of Lead Independent Director (LID)*

To counteract the balance of power in the boardroom where a combined chair and CEO exists, we recommend the appointment of a lead independent director on the Board. The role of the LID facilitates the communication of independent directors as a whole and also acts as an important conduit for shareholders to discuss any relevant issues where the board chair may be conflicted. We propose the LID role is promoted within the Corporate Governance Code.

- *Minimum level of independence and committee composition*

In order to improve the level of independence on boards, we recommend that the Corporate Governance Code states a minimum level of 50% board independence. This would complement the listing requirement to have a minimum of three/one-third of the board comprising independent non-executive directors (INED). By setting out expectations in the market, momentum would be created in establishing boards with a greater independence. It would also provide momentum to current initiatives on the role and value of the INED, to ensure high quality and value-adding individuals are appointed.

Increasing the number of INED on the board would also allow board committee's to be comprised of wholly of independent directors in line with best practice.

- *External Board Effectiveness Reviews*

The current Hong Kong Corporate Governance Code states in provision B.1.9 that the board should conduct a regular evaluation of its performance. In order to ensure that the process is valuable for both the company and shareholders, LGIM encourages this to be strengthened to include that companies facilitate an external evaluation every three years and that it reports to

shareholders its findings. Such reviews are now commonplace in large companies globally and provide assurance to shareholders that the board and contributions of the INEDs are effective and to a high standard.

- *Voting regime for controlled companies*

In order to provide more transparency of the nomination and appointment of INEDs for companies with a controlling shareholder, we recommend that a dual voting regime (similar to the UK) is explored.

The dual voting process occurs when there is a clear mismatch between the vote cast by controlling shareholders and that of minority investors on the appointment of independent non-executive directors. We believe that Hong Kong will also benefit with a similar mechanism as it will provide more transparency on the views of independent minority investors in controlled companies.

In the short-term, disclosure of how minority investors voted on INED appointments would be a welcome first-step.

Transparency of Party Committee activity

We have seen a number of Chinese State Owned Enterprises listed in Hong Kong amending their constitutional documents (Articles of Association) to formally recognise the role of the Party Committee in their corporate governance structure.

Currently there is often limited information and transparency as to the role, membership and responsibilities of such a committee. We would welcome an amendment to the Corporate Governance Code to encourage such disclosures in the annual report, including how the Committee interacts with the Board and management.

Auditor rotation

Shareholders place considerable weight on the assurance provided by an independent and high quality external audit. Whilst the current Hong Kong Corporate Governance Code discusses rotation for audit partners and staff, it does not mention the rotation and tenure of the external auditor.

We expect companies to review the external auditor at regular intervals and periodically rotate the firm. This provides a number of advantages, in stimulating the audit market, emphasises that the audit is an asset for shareholders, and ensures key judgements are challenged and reviewed on a regular basis.

We encourage consideration of an inclusion within the Code to encourage regular re-tendering of the external auditor. LGIM expects, at a minimum, the external auditor to be re-tendered at least every ten years, and a company should change its auditor every twenty years.

If you have any questions, please do not hesitate to contact us directly.

Yours sincerely,



Jeannette Andrews, CFA
Corporate Governance Manager



David Patt.
Senior Analyst, Corporate Governance and Public Policy

APPENDIX A

LGIM RESPONSE TO QUESTIONS HONG KONG STOCK EXCHANGE

Part 1: Independent Non- Executive Directors (INED)

Overboarding and INED's time commitment

**1. Do you agree with our proposed amendment to CP A.5.5 as described in paragraph 36?
Please give reasons for your views.**

1.1. We agree, in principle, that enhanced disclosure detailing the reasons for electing an INED including an explanation as to why the board consider that individual to be independent is a step in the right direction. This provides assurance to investors' of the role INEDs play in the boardroom.

However, given the importance of this principal, we believe that this provision should be in the listing rules rather than as an extension to the Corporate Governance Code.

1.2. The threshold proposed by the HKEX on INED holding seven (or more) listed company directorships is too high. In order to perform effectively and devote sufficient time to the role, LGIM expects non-executive board memberships to be limited to a maximum of four to five independent directorships at any one time for any individual not in full time employment.

1.3. Further consideration should be given if the director is a current serving executive of a listed company. As this position is full-time and their primary responsibility, the individual would have less time to serve on other boards and therefore we would expect further restrictions on the number of external boards' they would sit on as a INED. In this case, the individual should hold no more than two directorships in total.

1.4. LGIM believes that it is important for executive and non-executive directors to seek outside board appointments as this will help broaden their skills and knowledge, enabling them to provide better quality input in board discussions and decision making. However, when taking up outside appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.

1.5. The size and type of company is also a factor which needs to be considered carefully. Larger companies with complicated structures and business models require INED to spend more time to understand its activities. The individual should ensure they have sufficient time to exercise their role effectively as stated currently in CP A.6.3.

1.6. The board should consider and discuss the risk of overboarding and its impact on director and board effectiveness at least annually.

1.7. We propose an extension to the current Corporate Governance Code Principle A.1 to include "a procedure whereby approval is sought by the board every time a new position is accepted". This change would ensure that interests of the current company and board come before the interests of the individual director who desires to sit on multiple boards.

Board diversity

- 2. Do you agree with our proposals to upgrade CP A.5.6 to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their corporate governance reports? Please give reasons for your views.**
- 3. Do you agree with our proposal to amend CP A.5.5 that it requires the board to state in the circular to shareholders accompanying the resolution to elect the director: (i) the process used for identifying the nominee; (ii) the perspectives, skills and experience that the person is expected to bring to the board; and (iii) how the nominee would contribute to the diversity of the board. Please give reasons for your views.**
- 4. Do you agree with our proposal to amend Mandatory Disclosure Requirement L. (d) (ii) as described in paragraph 56? Please give reasons for your views.**
 - 4.1. LGIM supports the disclosure of a diversity policy to be included in the listing rules. We believe a suitably diverse mix of skills, experience and perspectives is essential for a board to function and perform optimally. A diverse board can lead to improved business decisions, minimise business risk, improve the sustainability of profits growth and therefore maximise long-term returns for shareholders.
 - 4.2. LGIM expects that the board should be cognisant of all elements of diversity that appropriately represent the company's operations, including gender, age, nationality, ethnic origin, background and experience. Therefore, it is essential to have a good level of transparency on diversity in relation to the board's structure and the company's strategy.
 - 4.3. It is important to point out that whilst this consultation highlights other jurisdictions including diversity in their corporate governance codes to varying degrees, guidance outside official corporate governance codes has played an important part in encouraging greater gender-diversity on boards.
 - 4.4. For example, the Davies Report and Hampton-Alexander Review were key studies raising its profile in the UK. The reviews also contained targets to force momentum and action by market participants in tackling this issue. The 30% Club is a global initiative which also seeks to develop a diverse pool of talent for all businesses through the efforts of its Chair and CEO members who are committed to better gender balance within their own business. Such initiatives are important to set quantitative expectations and drive momentum.
 - 4.5. Diversity should not only be considered at board level, but also throughout the whole workforce in the company. LGIM expects companies to have aspirational goals and strategy in place to increase diversity within the business. Targets and timeframes should be set by the company in order to achieve its objective.
 - 4.6. Disclosure should also be made on the breakdown of the current employee diversity mix within management levels and the workforce as a whole. Expectation on the future trajectory in this area is welcome disclosure and will encourage the development of future talented executives and board directors. LGIM expects company specific content and detail in this area. Boiler plate language should be avoided.

- 4.7. Lastly, given the importance of the nomination process of a director and transparency needed for investors to assess the quality of the candidate at the AGM, we request that amendments made to CP A.5.5 be upgraded to a listing rule so its mandatory.

Factors affecting INED's independence

A) Cooling off periods for former professional advisers

- 5. Do you agree with our proposal to revise Rule 3.13 (3) so that there is a three-year cooling off period for professional advisers before they can be considered independent, instead of the current one year? Please give reasons for your views.**

5.1. We agree with the proposal to review Rule 3.13 and believe this is a step in the right direction.

5.2. However, we do not believe that a three-year cooling off period would sufficiently address the issue of independence given the business culture in the region and close relationship in the business community. In our experience, we believe that the connection and loyalty between an advisor/advisory firm and a family controlled shareholder is unlikely to be diminished after three years.

5.3. Our preference would be to state that former professional advisers are unlikely to be considered independent in any circumstances or that an extension to of the cooling off period is made to five years.

- 6. Do you agree with our proposal to revise CP C.3.2 so that there is a three-year cooling off period for a former partner of the issuer's existing audit firm before he can be a member of the issuer's audit committee? Please give reasons for your views.**

6.1. We agree with the proposal to review CP 3.2 and believe that aligning the cooling-off period ensures consistency with Rule 3.13(3).

6.2. However, for clarity, this should be reflected in the Rules because if a former partner/employee of a professional advisory firm cannot serve as an independent NED, then they should also not be appointed to Audit Committees during this period. LGIM expects Audit Committees to be composed of wholly independent NEDs and therefore recommend that Rule 3.21 is strengthened from its current position of having a majority independent.

B) Cooling off period in respect of material interests in business activities

- 7. Do you agree with our proposal to revise Rule 3.13(4) to introduce a one-year cooling off period for a proposed INED who has had material interests in the issuer's principal business activities in the past year? Please give reasons for your views.**

7.1. We disagree with this proposal and request that the amendment to Rule 3.13 (4) be consistent with the cooling off period for other key material relationships. For example, the current consultation requests three years although our preference would be five years.

7.2. For clarity and consistency, the HKEX should apply the same cooling-off period uniformly through Rule 3.13. Please refer to paragraph 10.3 for recommendations to bring the definition of independence in to line with global best practice standards.

C) Cross-directorships or Significant Links with other Directors

8. Do you agree with our proposal to introduce a new RBP A.3.3 to recommend disclosure of INEDs' cross-directorships or having significant links with other directors through involvements in other companies or bodies in the Corporate Governance Report? Please give reasons for your views.

8.1. We agree that disclosure of cross-directorships is important.

8.2. However, we strongly recommend that this provision is contained in the mandatory rules (Rule 3.13) alongside the rest of the criteria that determines the status of an independent director.

8.3. The relationship between directors that have cross-directorships or significant links impacts their independence and creates unnecessary conflicts. In addition, cross-directorships highlight potential areas for related party transactions which are of material interest to investors.

D. Family ties

9. Do you agree with our proposal to introduce a Note under Rule 3.13 to encourage inclusion of an INED's immediate family members in the assessment of the director's independence? Please give reasons for your views.

10. Do you agree with our proposal to adopt the same definition for "immediate family member" as Rule 14A.12(1)(a) as set out in paragraph 81? Please give reasons for your views.

10.1. In defining independence we believe that the definition to include immediate family members as stated in Rule 14A.12(1)(a) does not go far enough. This definition should be broadened to include individuals with close family ties as well as immediate family members.

10.2. This is because we believe that any family connection (whether immediate or not) between board members deem them as non-independent. We understand that this risk is more apparent in family owned businesses and where there is a controlling shareholder.

10.3. In addition to the point above, we would welcome a broader review of the definition of independence in Rule 3.13:

10.3.1. Rule 3.13(1) Note 1 states that "a candidate holding an interest of 5% or more will normally not be considered independent." We propose this provision should be strengthened by removing the word "normally" from the Rule.

10.3.2. Rule 3.13(1) rightly examines the independence of a director if they hold more than 1% of the number of issued shares of the listed issuer. We propose this

examination is expanded to include if the director “represents a shareholder of more than 1%.”

10.3.3. Rule 3.13(3) examines the conflict between a director, partner or principal of a professional advisor to the company and any person connected with a controlling shareholder. We recommend that this is extended to a major or controlling shareholder of a professional advisor to capture situations when the listed issuer outsources services to connected businesses.

10.3.4. In addition, whilst there is a reference in 3.13(3) with regards to employees of professional advisors, there is no mention of employees of the issuer. We recommend that Rule 3.13(6) includes “employees” and that the cooling off period is extended by one year to five years in order to be consistent where other material business relationships may exist or have existed in the past.

10.3.5. Lastly, Rule 3.13 does not have any reference to how remuneration can impact on the independence of a NED whether through a director’s fee, participation in incentive schemes or a member of the company’s pension scheme. Given that performance related incentives can affect the independence of a NED, we recommend that this is included in Rule 3.13.

10.4. We believe that the points highlighted in 10.3 of this paper are essential to capture all the important elements of independent criteria, as judged by shareholders, and is consistent with best practice in other jurisdictions.

Part 2: Nomination Policy

11. Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 to require an issuer to disclose its nomination policy adopted during the year? Please give reasons for your views.

11.1. We support the amendment to propose mandatory disclosure requirements on a company’s nomination policy.

11.2. This disclosure should be non-boiler plate and include a skills matrix of the make-up of the board in order to better inform investors of the current composition of skills and experience.

11.3. We note that in Hong Kong, many nomination committees’ do not meet on a regular basis throughout the year. We consider succession plans for the board and management to be complex, and an annual meeting of the nomination committee does not suggest sufficient attention on this issue. Requiring the articulation of the nomination policy will be a positive development to encourage the development of the role of the nomination committee.

11.4. LGIM expects the Nomination Committee Chairman to be answerable to shareholders if it is felt that appropriate succession plans for board members are not in place.

Part 3: Directors attendance at general meetings

Directors' attendance at general meetings

12. Do you agree with our proposal to amend CP A.6.7 by removing the last sentence of the current wording? Please give reasons for your views.

- 12.1. We do not agree with the proposal to amend CP A.6.7 because we believe it is critical that all board directors make themselves available to shareholders at general meetings.
- 12.2. General Meetings are a constructive mechanism to be used by both the company and shareholders to communicate and engage.
- 12.2.1. At the meeting, all directors have the opportunity to share company insights with their shareholders about the business performance, as well as the strategy and outlook going forward.
- 12.2.2. Shareholders also have the opportunity to pose questions to the board as a whole to get information or ask questions directly to a specific director with whom normally they will not get access.
- 12.3. Therefore, we believe that attendance from "all" directors is essential for this mechanism to work and should remain in the corporate governance code.

Chairman's annual meetings with INEDs

13. Do you agree with our proposal to revise CP A.2.7 to state that INEDs should meet at least annually with the chairman? Please give reasons for your views.

- 13.1. In Hong Kong the role of chair and CEO is often performed by the same individual. Therefore, for INEDs we believe that the proposal by the HKEX CP A.2.7 should be strengthened to include that "INEDs meet annually without the Chairman present".
- 13.2. We do not believe that relying on committee meetings (such as the audit committee) as being the forum for NEDs to meet is sufficient.
- 13.3. In addition, we believe it is beneficial for the INED's to meet individually with the Chairman of the company on an annual basis.

Part 4: Dividend Policy

14. Do you agree with our proposal to introduce CP E.1.5 requiring the issuer to disclose its dividend policy in the annual report? Please give reasons for your views

- 14.1. We agree that disclosure of dividend policies is beneficial and important. However, this should also be considered and extended in relation to a company's whole capital allocation policy.
- 14.2. Given the importance of capital allocation to investors, we recommend that this is made as a Rule rather than a Code Provision.

Part 5: Not answered