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THE STOCK EXCHANGE  
OF HONG KONG LIMITED  
LISTING DIVISION

The Hong Kong Exchanges and Clearing Limited  
11<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street, Central  
Hong Kong

Attention: The Listing Unit

31 March 2004

By Fax (2295 3106) & By Post

Dear Sir,

**Exposure of Draft Code on Corporate Governance Practices and  
Corporate Governance Report**

On behalf of The Hong Kong Institute of Company Secretaries, I have pleasure in enclosing its response to the Exposure Paper setting out the Draft Code on Corporate Governance Practices and the Draft Rules on Corporate Governance Report.

Yours faithfully,

Linda Wong  
Director, Professional Development

Encl.





**Response to the Hong Kong Exchanges and Clearing Limited on the Exposure Paper on the Draft Code on Corporate Governance Practices and Corporate Governance Report**

The Hong Kong Institute of Company Secretaries (“HKICS”) strongly supports the enhancement of corporate governance standards and practices embodied in the Code on Corporate Governance Practices and in the Rules on Corporate Governance Report, and submits its comments on the Exposure Paper below.

**1. Proposed Implementation Timetable**

On the assumption that the proposed implementation timetable applies to both the Code and the Corporate Governance Report, and that the intended effect of paragraph 16 of the Exposure Paper is to render first time compliance with the Code and publication of the Corporate Governance Report by issuers in their annual report and accounts falling to be published on or after 1 January 2006, HKICS supports the proposed implementation timetable.

**2. Presentation and format of the draft Code and Corporate Governance Report**

HKICS supports the two-tier approach adopted in the organization of the Code into Code Provisions, which are subject to a “comply or explain” requirement, and Recommended Best Practices, which issuers are encouraged to adopt or to disclose deviations therefrom.

However, HKICS observes the following: -

- (1) Overlapping between the Code Provisions and Recommended Best Practices. Examples include:
  - A.5.1 and A.5.5 on the continuing professional development of directors
  - A.5.2(a) and A.5.8 on non-executive directors’ functions regarding strategy and performance
  - C.2.1 and C.2.3 on directors’ annual report to shareholders on the effectiveness of internal controls
  - C.3.2(b) and C.3.6(b) on Audit Committee’s review on external auditor’s independence
- (2) Inclusion of Listing Rules or requirements of the Companies Ordinance in the Code Provisions. For example, the requirement to give 21 days’ notice of general meetings stated in paragraph E.1.3 is a legal requirement, to which the “comply or explain” concept is inapplicable.
- (3) Contradiction between certain Recommended Best Practices sections of the Code Provisions and the Rules on Corporate Governance Report. For example, establishment of a nomination committee is a Recommended Best Practice (A.4.4) but is stated to be one of the “Mandatory Disclosure Requirements” for the Corporate Governance Report (section 2(g)(i) and (ii)).

Accordingly, HKICS recommends that –

- (a) criteria for categorizing the two-tier approach of the Code Provisions be made clear;
- (b) the Rules on Corporate Governance Report be harmonized with the Code Provisions; and
- (c) the decision on whether requirements of the Companies Ordinance or of the Listing Rules are, or are not, to be included as Code Provisions be made.

## Corporate Governance Report

A Corporate Governance Report is required to be included in the annual report. Paragraph 20 of the Exposure Paper states that "The form and the content of the Corporate Governance Report are not prescriptive, except that listed issuers must comply with the mandatory disclosure requirements" (lines 3-5). HKICS interprets "not prescriptive" to mean that the contents of the Corporate Governance Report may be contained in various sections of the annual report. HKICS believes that the underlying objective lies in providing shareholders with adequate and accurate information, the packaging of which should not be subject to dictation.

### **3. Ambiguities in the wording of the provisions of the draft Code**

#### **A. Directors**

##### **The Board**

A.1.6 - the requirement of sending minutes to all directors within a reasonable time is acceptable, but otherwise the specific wording of "(and generally within 14 days)", amounts to micro-management of a listed issuer. What constitutes a reasonable time should be left to the Board.

##### **Board composition**

A.3.1 - requires independent non-executive directors to be expressly identified as such "in all corporate communications that disclose the names of directors of the issuers". HKICS considers that such identification (which it is believed will extend to routine administrative communications with shareholders and paid announcements) serves no practical purpose and the requirement is therefore considered to be excessive.

##### **Appointments, re-election & removal of directors**

A.4.5(c) - proposes as a Recommended Best Practice that the nomination committee should be responsible for assessing the independence of independent non-executive directors. HKICS takes the view that the determination of independence should be a matter for the Board as a whole and not the Exchange. HKICS recommends that the Listing Rules be amended to this effect.

##### **Supply of and access to information**

A.6.2 - requires that "the board should have separate and independent access to the issuer's senior management". What will constitute "separate and independent" access? Would access to the company secretary constitute compliance?

#### **B. Remuneration of Directors and Senior Management**

##### **The level and make-up of remuneration and disclosure**

B.1.3 - requires the terms of reference of the remuneration committee to include certain minimum specific duties. HKICS takes the view that provided the principle as stated in the Code Provisions is applied, the delegation of powers of a Board to a committee should not be diminished or otherwise restricted. The decision on the detail of the delegated authority to be conferred on the remuneration committee should rest with the Board.

## **C. Accountability and Audit**

### **Financial reporting**

- C.1.4 - proposes quarterly reporting "using the accounting policies applied to the issuer's half-year and annual accounts". In relation to the issue of proposed quarterly reporting, in its submission to the Exchange on the *Consultation Paper on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues* in May 2002, HKICS states that "our concern is that quality should not be sacrificed for frequency, otherwise quarterly reporting would be reduced to a mere form without substance". As the debate on the merits or otherwise of quarterly reporting is still ongoing, HKICS considers it premature to include this item as a Recommended Best Practice in the Code.

### **Audit Committee**

- C.3.1 - requires minutes of audit committee to be sent to all committee members "within a reasonable time (and generally within 14 days)". Comments made under A.1.6 apply here. The specified days should be deleted.
- C.3.2 - requires detailed terms of reference for the audit committee, which are, as in the case with the remuneration committee, overly prescriptive. HKICS takes the same view of such requirement as that expressed under B.1.3.

**A Code is not an operating manual or a handbook.** Inherent obligations need not be spelt out, for instance, "The audit committee should report to the board" (C.3.2(c)) and "to report to the board on the matters set out in this code provision" (C.3.2(j)). Furthermore, to require the audit committee "to review the group's **operating...** policies and practices" goes beyond what would ordinarily be expected of an audit committee.

As protection against abuse is offered to shareholders under C.3.3, HKICS recommends the inclusion of only the following paragraphs under C.3.2:

- (a);
- (b) - first sentence only;
- (c) - first sentence only;
- (d) - first sentence only and without any sub-paragraphs; and
- (e) - which should incorporate "financial and accounting policies and practices" now under (i).

## **D. Delegation by The Board**

### **Board Committees**

- D.2.2 - requires Board committees "to report back to the board on their decisions or recommendations, unless there are legal or regulatory restrictions on their ability to do so". As these committees are formed under the authority of the Board, reporting back to the Board is a standard practice but the form of report should be a matter for the Board to decide rather than entombed as a term of reference.

## **E. Communications with Shareholders**

### **Voting by poll**

- E.2.3 - requires the Chairman, at the commencement of a shareholders meeting, to provide procedures for demanding a poll and detailed procedures for conducting a poll. In view of the new Listing Rules requiring the procedures for demanding a poll to be included in the notice of General Meeting, this requirement should be deleted.

4. Commentary on Provisions in the UK Combined Code Not adopted in the Draft Code (Appendix III)

Role of Company Secretary

The Code Provisions do not include provisions similar to those in the UK Combined Code that :

- (a) a company secretary has a responsibility to ensure good information flow and facilitate induction and assist with professional development as required;
- (b) a company secretary has a responsibility to advise the board on all governance matters; and
- (c) appointment and removal of a company secretary is to be a matter for the Board as a whole.

HKICS shares the views expressed in the Exposure Paper that “including equivalent provisions in the Code would reflect the increasing importance, breadth and complexity of corporate governance issues for Hong Kong boards” (paragraph 8 on page 45). **HKICS submits that such views are based on the well recognized fact that the growing volume and complexity of regulation has significantly diminished the ability of individual directors themselves to monitor and ensure corporate compliance levels but has correspondingly increased the role of the company secretary in effecting due compliance with the enhanced corporate governance standards and practices to be implemented.**

HKICS further submits that a company secretary who is not duly recognised is likely to be put in a difficult position to uphold the principles stated in the Code or to maintain the required minimum standards of corporate governance practices. The company secretary is, in the eyes of the law, an officer of the company. However, in the context of the company, he is a member of its executive management, typically at a lower hierarchical level than senior management colleagues with whom he may interface and who, in turn, have significant roles vis-a-vis the Board. **It is to avoid his role as an officer of the company being inappropriately subordinated to his position as an employee subject to the direction of his corporate superior that a degree of external recognition and reinforcement of his role, such as through the Code, is necessary.**

HKICS regrets the absence of the appropriate provisions in the draft Code but remains hopeful that, for the reasons explained, an authoritative source of reference to the statutory and regulatory obligations of the company secretary in relation to discharging his duties and responsibilities to the Board will be provided in due course.

March 2004