

**EXPOSURE OF  
DRAFT CODE ON CORPORATE GOVERNANCE PRACTICES  
AND  
CORPORATE GOVERNANCE REPORT**

**January 2004**



**Hong Kong Exchanges and Clearing Limited**

## **Message from the Secretary for Financial Services and the Treasury**

Good corporate governance holds the key to our reputation as a leading international financial centre and the premier capital formation centre for our country. To maintain our competitive status, it is imperative for us to upgrade the quality of our market by bringing our corporate governance standards in line with international standards and practices.

I am pleased to note the release of the proposed Code of Corporate Governance Practices and Corporate Governance Report, which has been made possible by the efforts of the Securities and Futures Commission, Hong Kong Exchanges and Clearing Limited and the Main Board and GEM Listing Committees of the Stock Exchange of Hong Kong Limited.

Indeed, the success of any initiative to enhance corporate governance is not solely premised on rules, codes and guidelines. It requires the nurturing of good corporate culture. I therefore appeal to all market players to contribute to the upgrading of our market quality by practising good corporate governance.



**Frederick MA Si-hang**

Secretary for Financial Services and the Treasury  
Hong Kong Special Administrative Region

## FOREWORD

For Hong Kong to maintain a competitive status as an international financial centre, it is crucial that listed issuers should practise good corporate governance.

The proposed Code on Corporate Governance Practices and the associated Corporate Governance Report are a most welcome addition to the regulatory standards for listed issuers in Hong Kong. They represent international benchmarks to which listed issuers should aspire.

Their adoption will be a major development. The impact on listed issuers and their directors should not be underestimated. Nor should the importance and benefits of enhanced investor confidence that should result.

The Code is designed to maintain flexibility to allow listed issuers of different size and complexity a free hand to explain their reasons for adopting particular governance practices.


For this approach to be successful it is incumbent on listed issuers and their directors to apply the spirit of the Code and to be prepared and willing to explain the substance of their governance arrangements to shareholders and others in clear and unambiguous terms.

Equally, shareholders and others involved in evaluating listed issuers' disclosures should do so with due regard to the circumstances of each issuer and with common sense. They should also be willing to engage in a constructive dialogue with listed issuers on the development of issuers' practices.



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The Securities and Futures  
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# **PART A**

## **INTRODUCTION**

### **BACKGROUND**

1. In January 2002, we published the Consultation Paper on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues (the “Consultation Paper”) inviting views on, among other things, our proposed amendments to the Code of Best Practice, which will be renamed the Code on Corporate Governance Practices (the “Code”), and the Report on Corporate Governance Practices (the “Corporate Governance Report”). We proposed to adopt the philosophy of “comply or explain” pioneered in the UK Combined Code. This approach is increasingly becoming the international norm for addressing the issue of how to provide greater transparency to corporate governance practices. We received wide support from respondents for this proposal.
2. In the Consultation Paper, we sought market views on the framework and certain key provisions and did not set out in detail the changes proposed to the Code and detailed disclosure requirements for the Corporate Governance Report.
3. We set out the proposed framework and key provisions in the Code and the detailed disclosure requirements for the Corporate Governance Report in the Consultation Conclusions on Proposed Amendments to the Listing Rules Relating to Corporate Governance Issues (the “Consultation Conclusions”) issued in January 2003. In May 2003 we set up a Corporate Governance working group to assist us in reviewing and considering the detailed provisions and requirements of the draft Code and Corporate Governance Report.
4. Membership of the working group was widely drawn to ensure a balanced representation of the disparate views and priorities that exist in the market. It comprised members working in the business, academic and public practice sectors, together with a number of members of the Listing Committee. We have incorporated the working group’s comments, to the extent practicable, in the draft Code and Corporate Governance Report. We are especially grateful to the members of the working group for the time and effort they have spent in reviewing and providing input on the draft Code and Corporate Governance Report. Despite the differing perspectives, the working group applied itself to the task in a co-operative and constructive manner and made a significant contribution to producing a text which we believe is capable of being supported by the market at large.

5. The proposed draft Code and Corporate Governance Report are attached as Appendices I and II to this document. Their contents are based on the recommendations set out in the Consultation Conclusions, with further amendments that are largely an elaboration on and extension of the recommendations. At the same time, we have also had regard to the latest regulatory practices, experience and developments in Hong Kong and other jurisdictions. In particular we have taken into account the principles and guidelines set out in the revised UK Combined Code published by the Financial Reporting Council in the UK in July 2003 and the proposals set out in the consultation paper issued by the Standing Committee on Company Law Reform in June 2003. The draft Code therefore comprises elements which reflect the best current market practices and international standards.
6. The UK Combined Code includes recommended board practices relating to evaluation of board's performance, institutional investors, appointment of senior independent directors and role of company secretary. We do not propose to include these provisions in the Code for the time being but to reconsider the relevance of these provisions as part of our post-implementation review of the Code. We include in Appendix III to this document our views on these provisions.
7. The draft Code is a significant enhancement of the existing Code. It provides useful support for listed issuers in advancing board practices and promoting good corporate governance practices. Its implementation is part of the Exchange's efforts to bolster corporate governance standards for listed issuers and represents a step in the right direction for corporate governance in Hong Kong.
8. Corporate governance best practice standards are constantly evolving. The ongoing relevance and effectiveness of the Code provisions and reporting requirements will need to be monitored and reviewed. The Exchange will establish a periodic review of the Code to assess its implementation.
9. The Securities and Futures Commission supports the draft Code and Corporate Governance Report which it considers bring Hong Kong's requirements in line with those of the leading international financial markets.

## **PUBLIC EXPOSURE**

10. Regulatory standards cannot on their own dictate standards of conduct which promote corporate performance or which bolster investor confidence. Success will only follow if the standards, in letter and spirit, are embraced and supported by listed issuers and their directors.
11. The purpose of this document is to seek market views on the timing of the proposed implementation of the Code and Corporate Governance Report and to allow the market the opportunity to comment on the detailed wording, with a view to removing ambiguities and providing clarity. This will ensure that the language adopted in the Code is clear and concise.

## **COMMENTS**

12. Any comments on this document should be sent to the Listing Unit, 11th Floor, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong, or by electronic submission by e-mailing a response to [cvw@hkex.com.hk](mailto:cvw@hkex.com.hk). Comments should arrive no later than 31 March 2004.
13. The names of persons who submit comments on this document together with the whole or part of their submission may be disclosed to members of the public. Statements of the Exchange's policy on handling personal data are set out in Appendix IV.

## **NEXT STEPS**

14. Comments received will be given due consideration. We will, where appropriate, make appropriate modifications to the text of the draft Code and Corporate Governance Report to improve clarity. Subject to final approval of the Code and the Corporate Governance Report by the Listing Committee and the Securities and Futures Commission, we will then issue the Code and the Corporate Governance Report as appendices to the Listing Rules for Main Board issuers and GEM issuers.
15. At the same time we propose to delete the mandatory requirements regarding the Code provisions from the current GEM Rules and adopt the same Code for Main Board and GEM issuers with one exception. Quarterly reporting will be a recommended best practice for Main Board issuers whereas it will remain as a mandatory requirement in the GEM Rules (see paragraph 21).

## **PART B**

### **ISSUES**

#### **IMPLEMENTATION OF THE REVISED CODE**

16. We intend to publish the final Code in the first half of 2004. To allow listed issuers sufficient time to put in place processes and make preparation to ensure compliance with the Code, we propose that the provisions of the final Code with one exception will become effective for accounting periods commencing on or after 1 January 2005.
  
17. The smooth implementation of Code provision C.2 on “Internal Controls” and the related disclosure obligations will be assisted by a longer transitional period and also by the provision of further guidance. We have invited the Hong Kong Society of Accountants to issue further guidance, developed from guidelines set out in the “Internal Control: Guidance for Directors on the Combined Code” (UK Turnbull Guidance) published in the UK in September 1999, to help listed issuers understand the proposed Code provisions and devise their internal control procedures. We propose that section C.2 of the draft Code on “Internal Controls” and the proposed disclosure requirements in the Corporate Governance Report relating to listed issuers’ internal controls will be implemented for accounting periods commencing on or after 1 July 2005.

***Q1. Do you support the proposed implementation timetable? If not, please specify those Code provisions that you consider it would not be possible to comply with within the expected timeframe for compliance. Please provide recommendations for alternative implementation provisions.***



## **PRESENTATION AND FORMAT**

18. The draft Code consists of two tiers of recommended board practices. The first tier contains the Code provisions. A listed issuer can adopt its own code on terms no less exacting than the Code provisions. It is expected that listed issuers will comply with the Code provisions most of the time. However, having regard to the fact that listed issuers may vary in board structure, size and complexity of operations and the nature of the risks and challenges they face, we consider that deviation(s) from the Code provisions may be justified in particular circumstances. A listed issuer will be required to confirm in the Corporate Governance Report that it meets the Code provisions or, where it does not, to give a considered explanation of its own practices that fall below the Code provisions. A listed issuer may also disclose in its Corporate Governance Report its own practices that are above the Code provisions. Under this “comply or explain” approach, it is for shareholders and others to evaluate the company’s disclosures.
  
19. The second tier of board practices comprises the recommended best practices. We consider that enhancement of corporate governance standards should be a progressive process. We therefore propose not to incorporate the full range of relevant international practices into the Code provisions in one go. As a move towards our long-term aim to bring our standards into line with the best international market practices, we have included a set of recommended best practices in the Code that listed issuers are encouraged to adopt as part of their code of board practices. These guidelines are mainly based on certain UK Combined Code provisions and guidelines set out in the UK Turnbull Guidance and the “Audit Committees Combined Code Guidance” (UK Smith Guidance) issued in the UK in January 2003. A listed issuer that has not adopted the recommended best practices will not be required to disclose any deviation in its Corporate Governance Report, but is encouraged to make disclosure in the same way as for deviations from the Code provisions.

20. Listed issuers will be required to include a Corporate Governance Report in their annual report and disclose information relating to their corporate governance practices in the report. The form and the content of the Corporate Governance Report are not prescriptive, except that listed issuers must comply with the mandatory disclosure requirements. Listed issuers should ensure that the report is clear and transparent, so as to enable shareholders and others to evaluate the company's statement. The Corporate Governance Report consists of three levels of disclosure requirements. The first level comprises mandatory disclosure requirements. Any failure to comply with the mandatory disclosure requirements will be regarded as a breach of the Listing Rules. The second level summarises the Code provisions relating to disclosure of the listed issuer's corporate governance practices. These Code provision disclosures are not mandatory disclosure requirements. However, listed issuers will be required to explain any non-disclosure in the Corporate Governance Report. The third level consists of recommended disclosures that listed issuers are encouraged to include in their Corporate Governance Report.
21. Under the current GEM Rules, the Code provisions, which are principally based on the existing Main Board Code, are mandatory requirements for GEM issuers. We propose to adopt the same Code for Main Board and GEM issuers with one exception. Quarterly reporting will be a recommended best practice for Main Board issuers whereas it will remain as a mandatory requirement in the GEM Rules.

***Q2. Do you support the presentation and format of the draft Code and Corporate Governance Report? If not, please provide details of your concerns and recommendations.***

***Q3. Are there any ambiguities in the wording of the provisions of the Code? If so, how could these ambiguities be clarified?***

## APPENDIX I

### DRAFT CODE ON CORPORATE GOVERNANCE PRACTICES

#### APPENDIX 14

#### CODE ON CORPORATE GOVERNANCE PRACTICES

*This Code on Corporate Governance Practices sets out the principles of good governance, code provisions of, and recommended best practices concerning, the general management responsibilities of the board of directors.*

*Issuers are required to make a disclosure statement in two parts in relation to this Code. In the first part, an issuer has to report on how it applies the principles in this Code. In the second part, an issuer has either to confirm that it complies with the code provisions or, where it does not, to provide an explanation.*

*Issuers and their directors may deviate from the code provisions set out in this Code, but any such deviations during the financial year, together with the reasons for such deviations, must be disclosed in the report on corporate governance practices which is required to be issued in accordance with Appendix 17 to the Exchange Listing Rules (the “Corporate Governance Report”) for inclusion in their summary financial reports (if any) and annual reports. Issuers must also disclose any deviations from the code provisions set out in this Code during the financial period being reported on, together with reasons for such deviations in their summary half-year reports (if any) and their half-year reports. Every issuer must review each provision carefully and give a considered explanation if it departs from the provisions. It is for shareholders and others to evaluate the issuer’s disclosure. For half-year reports, where there have been no changes to the deviations to code provisions as disclosed in the Corporate Governance Report contained in their immediately preceding summary financial reports (if any) and annual reports or there are new deviations to the code provisions not previously reported on, issuers may disclose the relevant deviations and reasons for such deviations by reference to their preceding summary financial reports (if any) and annual reports. Where such practice is adopted, issuers should ensure that the reference to the earlier report is clear and unambiguous. Any such failure to disclose will be regarded as a breach of the Exchange Listing Rules.*

*The recommended best practices set out in this Code are for guidance only and may assist issuers in adopting suitable governance practices. Although no disclosure is required in respect of deviations from such recommended best practices, issuers are encouraged to make disclosure in the same way as for deviations from the code provisions.*

*Issuers may devise their own codes on no less exacting terms. Issuers that have adopted their own codes that exceed the code provisions set out in this Code may draw attention to such fact in their summary half-year reports (if any) and their half-year reports and the summary of the Corporate Governance Report contained in their summary financial reports (if any) and the Corporate Governance Report contained in the annual reports.*

# **PRINCIPLES OF GOOD GOVERNANCE, CODE PROVISIONS AND RECOMMENDED BEST PRACTICES**

## **A. DIRECTORS**

### **A.1 The Board**

#### **Principle**

An issuer should be headed by an effective board which should assume responsibility for leadership and control of the issuer and be collectively responsible for promoting the success of the issuer by directing and supervising the issuer's affairs. Directors should take decisions objectively in the interests of the issuer.

#### **Code Provisions**

- A.1.1 The Board should meet regularly and board meetings should be held at least four times a year at approximately quarterly intervals. It is expected that such regular board meetings will normally involve the active participation, either in person or through other electronic means of communication, of a majority of directors entitled to be present. Accordingly, a regular meeting does not include the practice of obtaining board consent through the circulation of written resolutions.
- A.1.2 Arrangements should be in place to ensure that, other than in exceptional circumstances, all directors are given an opportunity to include matters in the agenda for a board meeting.
- A.1.3 Other than in exceptional circumstances, notice of at least 14 days should be given of a board meeting to give all directors an opportunity to attend.
- A.1.4 All directors should have access to the advice and services of the company secretary with a view to ensuring that board procedures, and all applicable rules and regulations, are followed.
- A.1.5 Minutes of board meetings and meetings of board committees should be kept by a duly appointed secretary of the meeting and such minutes should be open for inspection at any reasonable time on reasonable notice by any director.

- A.1.6 Minutes of board meetings and meetings of board committees should record in sufficient detail the matters considered by the board and decisions reached, including any concerns raised by directors or dissenting views expressed. Minutes of board meetings should be sent to all directors within a reasonable time (and generally within 14 days) after the board meeting is held.
- A.1.7 There should be a procedure agreed by the board to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the issuer's expense. The board should resolve to provide separate independent professional advice to directors to assist the relevant director or directors to discharge his/their duties to the issuer.
- A.1.8 If a substantial shareholder or a director has a conflict of interest in a matter to be considered by the board, the matter should not be dealt with by way of circulation or by a committee (except an appropriate board committee set up for that purpose pursuant to a resolution passed in a board meeting) but a board meeting should be held. Independent non-executive directors who have no material interest in the transaction should be present at such board meeting.

- Notes:*
1. *Directors are reminded of the requirement under rule 13.44 that they must abstain from voting on any board resolution in which they or any of their associates have a material interest and that they shall not be counted in the quorum present at the board meeting. The existing exceptions to the general voting prohibition are currently set out in note 1 of Appendix 3 to the Exchange Listing Rules.*
  2. *Such exceptions to the general voting prohibition should also be taken into account when considering whether a substantial shareholder or a director has a conflict of interest in a matter to be considered by the board. If the relevant exceptions apply, a regular board meeting need not be held. For this purpose, please refer to A.1.1 for the meaning of a regular board meeting.*

## **Recommended Best Practices**

A.1.9 An issuer should arrange appropriate insurance cover in respect of legal action against its directors.

## **A.2 Chairman and Chief Executive Officer**

### **Principle**

There are two key aspects of the management of every issuer — the management of the board and the day-to-day management of the issuer's business. There should be a clear division of these responsibilities at the board level to ensure a balance of power and authority, so that power is not concentrated in any one individual.

### **Code Provisions**

A.2.1 The roles of chairman and chief executive officer should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and chief executive officer should be clearly established and set out in writing.

*Note: Under paragraphs 2(c) (vii) and 2(d) of Appendix 17 to the Exchange Listing Rules, issuers must disclose in their Corporate Governance Report the identity of the chairman and the chief executive officer and whether these two roles are segregated and the nature of any relationship (including financial, business, family or other material/relevant relationship(s)), if any, among members of the board and in particular, between the chairman and the chief executive officer.*

A.2.2 The chairman should ensure that all directors are properly briefed on issues arising at board meetings.

A.2.3 The chairman should be responsible for ensuring that directors receive adequate information, which must be complete and reliable, in a timely manner.

## **Recommended Best Practices**

- A.2.4 One of the important roles of the chairman is to provide leadership for the board. The chairman should ensure that the board works effectively and discharges its responsibilities, and that all key and appropriate issues are discussed by the board in a timely manner. The chairman should be primarily responsible for drawing up and approving the agenda for each board meeting taking into account, where appropriate, any matters proposed by the other directors for inclusion in the agenda. The chairman may delegate such responsibility to a designated director or the company secretary.
- A.2.5 The chairman should take responsibility for ensuring that good corporate governance practices and procedures are established.
- A.2.6 The chairman should encourage all directors to make a full and active contribution to the board's affairs and take the lead to ensure that the board acts in the best interests of the issuer.
- A.2.7 The chairman should at least annually hold meetings with the non-executive directors (including independent non-executive directors) without the executive directors present.
- A.2.8 The chairman should ensure that appropriate steps are taken to provide effective communication with shareholders and that views of shareholders are communicated to the board as a whole.
- A.2.9 The chairman should facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

## **A.3 Board composition**

### **Principle**

The board should have a balance of skills and experience appropriate for the requirements of the business of the issuer. The board should ensure that changes to its composition can be managed without undue disruption. The board should include a balanced composition of executive and non-executive directors (including independent non-executive directors) so that there is a strong independent element on the board, which can effectively exercise independent judgement. Non-executive directors should be of sufficient calibre and number for their views to carry weight.

- Notes:*
- 1. Under rule 3.10 of the Exchange Listing Rules, every board of directors of a listed issuer must include at least three independent non-executive directors.*
  - 2. Guidelines on independence of independent non-executive directors are set out in rule 3.13 of the Exchange Listing Rules.*

### **Code Provisions**

A.3.1 The independent non-executive directors should be expressly identified as such in all corporate communications that disclose the names of directors of the issuer.

*Note: Under paragraph 2(c)(i) of Appendix 17 to the Exchange Listing Rules, issuers must disclose the composition of the board, by category of directors, including names of chairman, executive directors, non-executive directors and independent non-executive directors in the Corporate Governance Report.*

### **Recommended Best Practices**

- A.3.2 An issuer should appoint independent non-executive directors representing at least one-third of the board.
- A.3.3 An issuer should maintain on its website an updated list of its directors identifying their role and function and whether they are independent non-executive directors.



## **A.4 Appointments, re-election and removal**

### **Principle**

There should be a formal, considered and transparent procedure for the appointment of new directors to the board. There should be plans in place for orderly succession for appointments to the board. All directors should be subject to re-election at regular intervals. An issuer must explain the reasons for the resignation or removal of any director.

### **Code Provisions**

A.4.1 Non-executive directors should be appointed for a specific term, subject to re-election.

*Note: Under paragraph 2(e) of Appendix 17 to the Exchange Listing Rules, issuers must disclose the term of appointment of non-executive directors in the Corporate Governance Report.*

A.4.2 All directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director should be subject to retirement by rotation at least once every three years.

*Notes: 1. The names of all directors submitted for election or re-election must be accompanied by the same biographical details as required for newly appointed directors set out in rule 13.51(2) (including other directorships held in listed public companies in the last three years and other major appointments) to enable shareholders to make an informed decision on their election.*

*2. If a director resigns or is removed from office, an issuer must comply with the disclosure requirements in rule 13.51(2) and include in its announcement about the director's resignation or removal the reasons given by the director for his resignation (including but not limited to information relating to a relevant director's disagreement with the issuer, if any, and a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders).*

## **Recommended Best Practices**

A.4.3 Serving more than nine years could be relevant to the determination of a non-executive director's independence. If an independent non-executive director serves more than nine years, any further appointment of such independent non-executive director should be subject to a separate resolution to be approved by shareholders. The board should set out to shareholders in the papers accompanying a resolution to elect such an independent non-executive director the reasons they believe that the individual continues to be independent and why he should be re-elected.

A.4.4 Issuers should establish a nomination committee comprising a majority of independent non-executive directors.

A.4.5 The nomination committee should be established with specific written terms of reference which deal clearly with the committee's authority and duties. It is recommended that the nomination committee should discharge the following duties:

- (a) review the structure, size and composition (including the skills, knowledge and experience) of the board on a regular basis and make recommendations to the board regarding any proposed changes;
- (b) identify individuals suitably qualified to become board members and select or make recommendations to the board on the selection of, individuals nominated for directorships;
- (c) assess the independence of independent non-executive directors; and
- (d) make recommendations to the board on relevant matters relating to the appointment or re-appointment of directors and succession planning for directors in particular the chairman and the chief executive officer.

A.4.6 The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.

*Notes: 1. This requirement would be met by making it available on request and by including the information on the issuer's website.*

- 2. Under paragraph 2(g)(i) of Appendix 17 to the Exchange Listing Rules, issuers must explain the role of the nomination committee (if any) in the Corporate Governance Report.*

A.4.7 The nomination committee should be provided with sufficient resources to discharge its duties.

A.4.8 Where the board proposes a resolution to elect an individual as an independent non-executive director at the general meeting, it should set out in the circular to shareholders and/or explanatory statement accompanying the notice of the relevant general meeting why they believe the individual should be elected and the reasons why they consider the individual to be independent.

## **A.5 Responsibilities of directors**

### **Principle**

Every director is required to keep abreast of his responsibilities as a director of an issuer and of the conduct, business activities and development of that issuer. Given the essential unitary nature of the board, non-executive directors have the same duties of care and skill and fiduciary duties as executive directors.

*Note: These duties are summarised in the Non-statutory Guidelines on Directors' Duties issued by the Companies Registry in January 2004. In determining whether a director has met the requisite standard of care, skill and diligence expected of him, courts will generally have regard to a number of factors. These include the functions that are to be performed by the director concerned, whether the director is a full-time executive director or a part-time non-executive director and the professional skills and knowledge of the director concerned.*

### **Code Provisions**

A.5.1 Every newly appointed director of an issuer should receive a comprehensive, formal and tailored induction on the first occasion of his appointment, and subsequently such briefing and professional development as is necessary, to ensure that he has a proper understanding of the operations and business of the issuer and that he is fully aware of his responsibilities under statute and common law, the Exchange Listing Rules, applicable legal requirements and other regulatory requirements and the business and governance policies of the issuer. This code provision also applies to directors of new listing applicant.

A.5.2 The functions of non-executive directors should include but should not be limited to the following:

- (a) participating in board meetings of the issuer to bring an independent judgement to bear on issues of strategy, performance, resources, key appointments and standards of conduct;
- (b) taking the lead where potential conflicts of interests arise; and
- (c) serving on the audit, remuneration, nomination and other governance committees, if invited.

A.5.3 Every director should ensure that he can give sufficient time and attention to the affairs of the issuer and should not accept the appointment if he cannot do so.

A.5.4 Directors must comply with their obligations under the Model Code set out in Appendix 10 to the Exchange Listing Rules and, in addition, the board should establish written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealings in the securities of the issuer. For this purpose, “relevant employee” includes any employee of the issuer or a director or employee of a subsidiary or holding company of the issuer who, because of such office or employment, is likely to be in possession of unpublished price sensitive information in relation to the issuer or its securities.

### **Recommended Best Practices**

A.5.5 All directors should participate in a programme of continuous professional development to develop and refresh their knowledge and skills to help ensure that their contribution to the board remains informed and relevant. The issuer should be responsible for arranging and funding a suitable development programme.

A.5.6 Each director should disclose to the issuer at the time of his appointment, and on a periodic basis, the number and nature of offices held in public companies or organisations and other significant commitments, with the identity of the public companies or organisations and an indication of the time involved.

A.5.7 Non-executive directors, as equal board members, should give the board and any committees on which they serve such as the audit, remuneration or nomination committees the benefit of their skills, expertise and varied backgrounds and qualifications through regular attendance and active participation. They should also attend general meetings and develop a balanced understanding of the views of shareholders.

A.5.8 Non-executive directors should have the following functions:

- (a) making a positive contribution to the development of the issuer's strategy through independent, constructive and informed comments; and
- (b) scrutinising the issuer's performance in achieving agreed corporate goals and objectives, and monitoring the reporting of performance.

## **A.6 Supply of and access to information**

### **Principle**

Directors should be provided in a timely manner with appropriate information in such form and of such quality as will enable them to make an informed decision and to discharge their duties and responsibilities as directors of an issuer.

### **Code Provisions**

A.6.1 Other than in exceptional circumstances, an agenda and accompanying board papers should be sent in full to all directors in a timely manner and at least three days before the intended date of a board meeting (or such other longer period as the board agrees).

A.6.2 Management has an obligation to supply the board with adequate information in a timely manner to enable it to make informed decisions. The information supplied must be complete and reliable. To fulfil his duties properly a director may not in all circumstances be able to rely purely on what is volunteered by management and further enquiries may be required. Where any director requires more information than is volunteered by management, he should make further enquiries where necessary. The board should have separate and independent access to the issuer's senior management.

*Notes: 1. The information provided should include background or explanatory information relating to matters to be brought before the board, copies of disclosure documents, budgets, forecasts and monthly and other relevant internal financial statements. In respect of budgets, any material variance between the projections and actual results must also be disclosed and explained.*

*2. For the purpose of this Code, “senior management” should refer to the same category of persons as referred to in the issuer’s annual report and is required to be disclosed under paragraph 12 of Appendix 16 to the Exchange Listing Rules.*

A.6.3 All directors are entitled to have access to board papers and related materials. Such papers and related materials should be prepared in such form and quality as will enable the board to make an informed decision on matters placed before it. Where queries are raised by directors, steps must be taken to respond as promptly and fully as possible.

## **B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT**

### **B.1 The level and make-up of remuneration and disclosure**

#### **Principle**

An issuer should disclose information relating to its directors’ remuneration policy and other remuneration related matters. There should be a formal and transparent procedure for setting policy on executive directors’ remuneration and for fixing the remuneration packages for all directors. Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. No director should be involved in deciding his own remuneration.

*Notes: 1. Under paragraph 24B of Appendix 16 to the Exchange Listing Rules, issuers are required to give a general description of the remuneration policy and long term incentive schemes of the group as well as the basis of determining the fees and any other benefits payable to their directors.*

*2. Under paragraph 24 of Appendix 16 to the Exchange Listing Rules, directors’ fees and any other reimbursement or emolument payable to a director must be disclosed in full in the annual reports and accounts of the issuer on an individual and named basis.*

## Code Provisions

- B.1.1 Issuers should establish a remuneration committee with specific written terms of reference which deal clearly with its authority and duties. A majority of the members of the remuneration committee should be independent non-executive directors.
- B.1.2 The remuneration committee should consult the chairman and/or chief executive officer about their proposals relating to the remuneration of other executive directors and have access to professional advice if considered necessary.
- B.1.3 The terms of reference of the remuneration committee should include, as a minimum, the following specific duties:

- (a) to make recommendations to the board on the issuer's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration;

*Note: For the purpose of this Code, "senior management" should refer to the same category of persons as referred to in the issuer's annual report and is required to be disclosed under paragraph 12 of Appendix 16 to the Exchange Listing Rules.*

- (b) to have the delegated responsibility to determine the specific remuneration packages of all executive directors and senior management, including benefits in kind, pension rights and compensation payments, including any compensation payable for loss or termination of their office or appointment, and make recommendations to the board of the remuneration of non-executive directors. The remuneration committee should consider factors such as salaries paid by comparable companies, time commitment and responsibilities of the directors, employment conditions elsewhere in the group and desirability of performance-based remuneration;

*Note: Please refer to the Note to B.1.3(a) of this Code for the definition of "senior management".*

- (c) to review and approve performance-based remuneration by reference to corporate goals and objectives resolved by the board from time to time;
- (d) to review and approve the compensation payable to executive directors and senior management in connection with any loss or termination of their office or appointment to ensure that such compensation is determined in accordance with relevant contractual terms and that such compensation is otherwise fair and not excessive for the issuer;

*Note: Please refer to the Note to B.1.3(a) of this Code for the definition of “senior management”.*

- (e) to review and approve compensation arrangements relating to dismissal or removal of directors for misconduct to ensure that such arrangements are determined in accordance with relevant contractual terms and that any compensation payment is otherwise reasonable and appropriate; and
- (f) to ensure that no director is involved in deciding his own remuneration and that, as regards the remuneration of a non-executive director who is a member of the remuneration committee, his remuneration should be determined by the other members of the remuneration committee.

*Note: The remuneration committee shall advise shareholders on how to vote with respect to any service contracts of directors that require shareholders’ approval under rule 13.68.*

B.1.4 The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.

*Notes: 1. This requirement would be met by making it available on request and by including the information on the issuer’s website.*

*2. Under paragraph 2(f)(i) of Appendix 17 to the Exchange Listing Rules, issuers must explain the role of the remuneration committee (if any) in the Corporate Governance Report.*

B.1.5 The remuneration committee should be provided with sufficient resources to discharge its duties.



## **Recommended Best Practices**

- B.1.6 A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.
- B.1.7 Issuers should disclose details of any remuneration payable to members of senior management, on an individual and named basis, in their annual reports and accounts.

*Note: For the purpose of this Code, "senior management" should refer to the same category of persons as referred to in the issuer's annual report and is required to be disclosed under paragraph 12 of Appendix 16 to the Exchange Listing Rules.*

## **C. ACCOUNTABILITY AND AUDIT**

### **C.1 Financial reporting**

#### **Principle**

The board should present a balanced, clear and comprehensible assessment of the company's performance, position and prospects.

#### **Code Provisions**

- C.1.1 Management should provide such explanation and information to the board as will enable the board to make an informed assessment of the financial and other information put before the board for approval.

*Note: Issuers are reminded of their obligation to comply with the financial reporting and disclosure requirements set out in the Exchange Listing Rules. Failure to comply with such requirements constitutes a breach of the Exchange Listing Rules.*

- C.1.2 The directors should acknowledge their responsibility for preparing the accounts, and there should be a statement by the auditors about their reporting responsibilities. The directors should prepare the accounts on a going concern basis, with supporting assumptions or qualifications as necessary. When the directors are aware of material uncertainties relating to events or conditions that may cast significant doubt upon the issuer's ability to continue as a going concern, such uncertainties should be clearly disclosed.

C.1.3 The board's responsibility to present a balanced, clear and understandable assessment extends to annual and half-year reports, other price-sensitive announcements and other financial disclosures required under the Exchange Listing Rules, and reports to regulators as well as to information required to be disclosed pursuant to statutory requirements.

### **Recommended Best Practices**

C.1.4 An issuer should announce and publish quarterly financial results within 45 days after the end of the relevant quarter, disclosing such information as would enable shareholders to assess the performance, financial position and prospects of the issuer. Any such quarterly financial reports should be prepared using the accounting policies applied to the issuer's half-year and annual accounts.

C.1.5 Once an issuer decides to announce and publish its quarterly financial results, it should continue to adopt quarterly reporting for each of the first three and nine months periods of subsequent financial years. Where the issuer decides not to announce and publish its financial results for a particular quarter, it should publish an announcement to disclose the reason(s) for such decision.

## **C.2 Internal controls**

### **Principle**

The board should ensure that the issuer maintains sound and effective internal controls to safeguard the shareholders' investment and the issuer's assets.

### **Code Provisions**

C.2.1 The directors should at least annually conduct a review of the effectiveness of the system of internal control of the issuer and its subsidiaries and report to shareholders that they have done so in their Corporate Governance Report. The review should cover all material controls, including financial, operational and compliance controls and risk management functions.

## **Recommended Best Practices**

C.2.2 The board's annual review should, in particular, consider:

- (a) the changes since the last annual review in the nature and extent of significant risks, and the issuer's ability to respond to changes in its business and the external environment;
- (b) the scope and quality of management's ongoing monitoring of risks and of the system of internal control, and where applicable, the work of its internal audit function and other providers of assurance;
- (c) the extent and frequency of the communication of the results of the monitoring to the board (or board committee(s)) which enables it to build up a cumulative assessment of the state of control in the issuer and the effectiveness with which risk is being managed;
- (d) the incidence of significant control failings or weakness that has been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the issuer's financial performance or condition; and
- (e) the effectiveness of the issuer's public reporting processes.

C.2.3 Issuers should disclose as part of the Corporate Governance Report a narrative statement how they have complied with the code provisions on internal control during the reporting period. The disclosures should also include the following items:

- (a) the process that an issuer has applied for identifying, evaluating and managing the significant risks faced by it;
- (b) any additional information to assist understanding of the issuer's risk management processes and system of internal control;
- (c) an acknowledgement by the board that it is responsible for the issuer's system of internal control and for reviewing its effectiveness;

- (d) the process that an issuer has applied in reviewing the effectiveness of the system of internal control; and
- (e) the process that an issuer has applied to deal with material internal control aspects of any significant problems disclosed in its annual reports and accounts.

C.2.4 Issuers should ensure that their disclosures provide meaningful, high-level information and do not give a misleading impression.

C.2.5 Issuers without an internal audit function should review the need for one on an annual basis and should disclose the outcome of such review in the issuers' Corporate Governance Report.

### **C.3 Audit Committee**

#### **Principle**

The board should establish formal and transparent arrangements for considering how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors. The audit committee established by an issuer pursuant to the Exchange Listing Rules should have clear terms of reference.

#### **Code Provisions**

C.3.1 Minutes of audit committee meetings should be kept by a duly appointed secretary of the meeting (who should normally be the company secretary). Minutes of the audit committee meetings should be sent to all members of the committee within a reasonable time (and generally within 14 days) after the meeting.

C.3.2 The terms of reference of the audit committee should include at least the following duties:

*Relationship with the issuer's auditors*

- (a) to be primarily responsible for making recommendation to the board on the appointment, reappointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor;

*Note: Issuers are reminded that rule 13.51(4) requires an announcement to be published when there is a change of auditors. The announcement must also include a statement as to whether there are any matters that need to be brought to holders of securities of the issuer.*

- (b) to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standard. The audit committee should discuss with the auditor the nature and scope of the audit and reporting obligations before the audit commences;
- (c) to develop and implement policy on the engagement of external auditor to supply non-audit services. For this purpose, external auditor shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally. The audit committee should report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken;

*Review of financial information of the issuer*

- (d) to monitor integrity of financial statements of an issuer and the issuer's annual report and accounts, half-year report and, if prepared for publication, quarterly reports, and to review significant financial reporting judgements contained in them. In this regard, in reviewing the issuer's annual report and accounts, half-year report and, if prepared for publication, quarterly reports before submission to the board, the committee should focus particularly on:
  - (aa) any changes in accounting policies and practices;
  - (bb) major judgmental areas;
  - (cc) significant adjustments resulting from audit;
  - (dd) the going concern assumption and any qualifications;
  - (ee) compliance with accounting standards; and
  - (ff) compliance with the Exchange Listing Rules and other legal requirements in relation to financial reporting;

*Oversight of the issuer's financial reporting system and internal control procedures*

- (e) to review the issuer's financial controls, internal control and risk management systems;
- (f) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system;
- (g) to consider any findings of major investigations of internal control matters as delegated by the board or on its own initiative and management's response;
- (h) where an internal audit function exists, to ensure co-ordination between the internal and external auditors, and to ensure that the internal audit function is adequately resourced and has appropriate standing within the issuer, and to review and monitor the effectiveness of the internal audit function;

- (i) to review the group's operating, financial and accounting policies and practices;
- (j) to report to the board on the matters set out in this code provision;  
and
- (k) to consider other topics, as defined by the board.

*Note: For further guidance on the duties of an audit committee, issuers may refer to the "Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence" issued by the Technical Committee of the International Organization of Securities Commissions in October 2002 and "A Guide for Effective Audit Committees" published by the Hong Kong Society of Accountants in February 2002. Issuers may also adopt the terms of reference set out in that guide, or they may adopt any other comparable terms of reference for the establishment of an audit committee.*

C.3.3 The audit committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.

*Notes: 1. This requirement would be met by making it available on request and by including the information on the issuer's website.*

*2. Under paragraph 2(i)(i) of Appendix 17 to the Exchange Listing Rules, issuers must explain the role of the audit committee in the Corporate Governance Report.*

C.3.4 Where the board disagrees with the audit committee's view on the selection, appointment, resignation or dismissal of the external auditors, the issuer should include in the Corporate Governance Report a detailed explanation of the audit committee's view and also the reason(s) why the board has taken a different view.

C.3.5 The audit committee should be provided with sufficient resources to discharge its duties.

## **Recommended Best Practices**

C.3.6 The terms of reference of the audit committee should also require audit committee:

- (a) to review arrangements by which employees of the issuer may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. The audit committee should ensure that proper arrangements are in place for the fair and independent investigation of such matters and for appropriate follow-up action;
- (b) to establish the following procedure to review and monitor independence of external auditors:
  - (i) consider all relationships between the issuer and the audit firm (including the provision of non-audit services);
  - (ii) seek from the audit firm, on an annual basis, information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding rotation of audit partners and staff; and
  - (iii) meet with the auditor, at least annually, in the absence of management, to discuss matters relating to its audit fees, any issues arising from the audit and any other matters the auditor may wish to raise;
- (c) to develop and recommend to the board the issuer's policy relating to provision of non-audit services by the auditor. The audit committee should ensure that the provision of such services does not impair the external auditor's independence or objectivity. In relation to non-audit services, the audit committee should consider:
  - (i) whether the skills and experience of the audit firm make it a suitable supplier of the non-audit services;



- (ii) whether there are safeguards in place to ensure that there is no threat to objectivity and independence in the conduct of the audit resulting from the provision of such services by the external auditor;
  - (iii) the nature of the non-audit services, the related fee levels and the fee levels individually and in aggregate relative to the audit firm; and
  - (iv) the criteria which govern the compensation of the individuals performing the audit;
- (d) to agree with the board the issuer's policies relating to the hiring of employees or former employees of the external auditors and monitor the application of such policies. The audit committee should consider whether in the light of this there has been any impairment or appearance of impairment, of the auditor's judgement or independence in respect of the audit;
- (e) to act as the key representative body for overseeing the issuer's relation with the external auditor;
- (f) to review the external auditor's management letter, any material queries raised by the auditor to management in respect of the accounting records, financial accounts or systems of control and management's response; and
- (g) to ensure that the board will provide a timely response to the issues raised in the external auditor's management letter.

## **D. DELEGATION BY THE BOARD**

### **D.1 Management functions**

#### **Principle**

An issuer should have a formal schedule of matters specifically reserved to the board for its decision. The board should give clear directions to management as to the matters that must be approved by the board before decisions are made on behalf of the issuer.

#### **Code Provisions**

D.1.1 When the board delegates aspects of its management and administration functions to management, it must at the same time give clear directions as to the powers of management, in particular, with respect to the circumstances where management should report back and obtain prior approval from the board before making decisions or entering into any commitments on behalf of the issuer.

*Note: The board should not delegate matters to a board committee, executive directors or management to an extent that would significantly hinder or reduce the ability of the board as a whole to discharge its functions.*

D.1.2 An issuer should formalise the functions reserved to the board and those delegated to management. It should review those arrangements on a periodic basis to ensure that they remain appropriate to the needs of the issuer.

*Note: Under paragraph 2(c)(iv) of Appendix 17 to the Exchange Listing Rules, issuers must include in their Corporate Governance Report a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.*

## **Recommended Best Practices**

- D.1.3 An issuer should disclose the division of responsibility between the board and management to assist those affected by corporate decisions to better understand the respective accountabilities and contributions of the board and management.
- D.1.4 Directors should clearly understand delegation arrangements in place. To that end, issuers should have formal letters of appointment for directors setting out the key terms and conditions relative to their appointment.

## **D.2 Board Committees**

### **Principle**

Board committees should be formed with specific written terms of reference which deal clearly with the committees' authority and duties.

### **Code Provisions**

- D.2.1 Where board committees are established to deal with matters, the board should prescribe sufficiently clear terms of reference to enable such committees to discharge their functions properly.
- D.2.2 The terms of reference of board committees should require such 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 (such as a restriction on disclosure due to regulatory requirements).

## **E. COMMUNICATION WITH SHAREHOLDERS**

### **E.1 Effective communication**

#### **Principle**

The board should endeavour to maintain an on-going dialogue with shareholders and in particular, use annual general meetings or other general meetings to communicate with shareholders and encourage their participation.

#### **Code Provisions**

- E.1.1 An issuer should propose a separate resolution at a general meeting on each substantially separate issue.
- E.1.2 The chairman of the board should attend the annual general meeting and arrange for the chairmen of the audit, remuneration and nomination committees (as appropriate) or in the absence of the chairman of such committees, another member of the committee or failing this his duly appointed delegate, to be available to answer questions at the annual general meeting. The chairman of the independent board committee (if any) should also be available to answer questions at any general meeting to approve a connected transaction or any other transaction that is subject to independent shareholders' approval.
- E.1.3 Issuers should arrange for the notice of general meetings and related papers to be sent to shareholders at least 21 days (in the case of an annual general meeting or a meeting requiring a special resolution) or 14 days (in the case of any other meetings) before the meeting.

*Note: Directors are reminded of the requirement under rule 13.73 that an issuer shall provide its shareholders with any material information on the subject matter to be considered at a general meeting that comes to the directors' attention after the relevant circular is issued. An issuer must provide the information either in a supplementary circular or by way of an announcement in newspapers not less than 14 days before the date of the relevant general meeting to consider the subject matter.*

## **E.2 Voting by Poll**

### **Principle**

The issuer should regularly inform shareholders of the procedure for voting by poll and ensure compliance with the requirements about voting by poll contained in the Exchange Listing Rules and the constitutional documents of the issuer.

### **Code Provisions**

- E.2.1 The chairman of a meeting should ensure disclosure in the issuer's circulars to shareholders of the procedures for and the rights of shareholders to demand a poll in compliance with the requirements about voting by poll contained in rule 13.39(4). In particular, pursuant to rule 13.39(3), the chairman of a meeting and/or directors who, individually or collectively, hold proxies in respect of shares representing 5% or more of the total voting rights at a particular meeting shall demand a poll in certain circumstances where, on a show of hands, a meeting votes in the opposite manner to that instructed in those proxies. If a poll is required under such circumstances, the chairman of the meeting should disclose to the meeting the total number of votes represented by all proxies held by directors indicating an opposite vote to the votes cast at the meeting on a show of hands.
- E.2.2 The issuer should count all proxy votes and, except where a poll is required, the chairman of a meeting should indicate to the meeting the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands. The issuer should ensure that votes cast are properly counted and recorded.
- E.2.3 The chairman of a meeting should at the commencement of the meeting ensure that an explanation is provided of:
- (a) the procedures for demanding a poll by shareholders before putting a resolution to the vote on a show of hands; and
  - (b) the detailed procedures for conducting a poll and then answer any questions from shareholders whenever voting by way of a poll is required.

## **APPENDIX II**

### **DRAFT RULES ON CORPORATE GOVERNANCE REPORT**

#### **APPENDIX 17**

#### **CORPORATE GOVERNANCE REPORT**

##### **GENERAL**

1. Listed issuers shall include a report on corporate governance practices (the “Corporate Governance Report”) prepared by the board of directors in their summary financial reports (if any) pursuant to paragraph 50 of Appendix 16 to the Exchange Listing Rules and annual reports pursuant to paragraph 34 of Appendix 16 to the Exchange Listing Rules. The Corporate Governance Report shall be comprehensive and shall contain all the information set out in paragraph 2 of this Appendix. For the purpose of inclusion in the summary financial reports, listed issuers may include a summary of the Corporate Governance Report with cross-references to their annual reports. The summary should contain, as a minimum, a narrative statement indicating overall compliance with and highlighting any deviation from the provisions of the Code on Corporate Governance Practices contained in Appendix 14 to the Exchange Listing Rules (the “Code”). Any failure to disclose the information contained in paragraph 2 of this Appendix in their Corporate Governance Report will be regarded as a breach of the Exchange Listing Rules. Paragraph 3 of this Appendix sets out the specific requirements under the code provisions in the Code which require disclosure by listed issuers in their Corporate Governance Report. Listed issuers are also encouraged to disclose information set out in paragraph 4 of this Appendix in their Corporate Governance Report.

## **MANDATORY DISCLOSURE REQUIREMENTS**

2. Listed issuers shall include the following information for the accounting period covered by the annual report and any significant events pertaining to the following information for any subsequent period up to the date of publication of the annual report, to the extent that is practicable:

**(a) Corporate governance practices**

- (i) a narrative statement of how the listed issuer has applied the principles in the Code, providing explanation which enables its shareholders to evaluate how the principles have been applied;
- (ii) a statement as to whether the listed issuer meets the code provisions in the Code and its own code. If a listed issuer has adopted its own code that exceeds the code provisions set out in the Code, such listed issuer may draw attention to such fact in its annual report; and
- (iii) in the event of any deviation from the code provisions in the Code, details of such deviation during the financial year (including the reasons for such deviations).

**(b) Directors' securities transactions**

In respect of the Model Code set out in Appendix 10 to the Exchange Listing Rules:

- (i) whether the listed issuer has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard set out in the Model Code;
- (ii) having made specific enquiry of all directors, whether the directors of the listed issuer have complied with, or whether there has been any non-compliance with, the required standard set out in the Model Code and its code of conduct regarding directors' securities transactions; and
- (iii) in the event of any non-compliance with the required standard set out in the Model Code, details of such non-compliance and an explanation of the remedial steps taken by the listed issuer to address such non-compliance.

**(c) Board of directors**

Details in relation to the board of directors of listed issuers, which include:

- (i) composition of the board, by category of directors, of the listed issuer, including name of chairman, executive directors, non-executive directors and independent non-executive directors;
- (ii) number of board meetings held during the financial year;
- (iii) individual attendance of each director, on a named basis, at the board meetings;
- (iv) a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management;
- (v) details of non-compliance (if any) with rules 3.10(1) and 3.10(2) of the Exchange Listing Rules and an explanation of the remedial steps taken by the listed issuer to address such non-compliance relating to appointment of a sufficient number of independent non-executive directors and an independent non-executive director with appropriate professional qualifications, or accounting or related financial management expertise, respectively;

*Note: Listed issuers are reminded of their obligation to comply with rules 3.10 (1) and (2) of the Exchange Listing Rules. Failure to comply with such requirements constitutes a breach of the Exchange Listing Rules.*

- (vi) reasons why the listed issuer considers an independent non-executive director to be independent where he/she fails to meet one or more of the guidelines for assessing independence set out in rule 3.13 of the Exchange Listing Rules; and
- (vii) relationship (including financial, business, family or other material/relevant relationship(s)), if any, among members of the board and in particular, between the chairman and the chief executive officer.



**(d) Chairman and chief executive officer**

- (i) identity of the chairman and chief executive officer; and
- (ii) whether the roles of the chairman and chief executive officer are segregated and are not exercised by the same individual.

**(e) Non-executive directors**

The term of appointment of non-executive directors.

*Note: Under Appendix 16 to the Exchange Listing Rules, listed issuers are required to give a general description of the remuneration policy and long term incentive schemes as well as the basis of determining the fees and any other benefits payable to their directors.*

**(f) Remuneration of directors**

The following information relating to the directors' remuneration policy:

- (i) the role and function of the remuneration committee (if any) or the reason(s) for not having a remuneration committee;
- (ii) the composition of the remuneration committee (if any) (including names and identifying in particular the chairman of the remuneration committee);
- (iii) the number of meetings held by the remuneration committee or the board of directors (if there is no remuneration committee) during the year to discuss remuneration related matters and the record of individual attendance of members, on a named basis, at meetings held during the year; and
- (iv) a summary of the work, including determining the policy for the remuneration of executive directors, assessing performance of executive directors and approving the terms of executive directors' service contracts, performed by the remuneration committee or board of directors (if there is no remuneration committee) during the year.

**(g) Nomination of directors**

The following information relating to the appointment and removal of directors:

- (i) the role and function of the nomination committee (if any);
- (ii) the composition of the nomination committee (if any) (including names and identifying in particular the chairman of the nomination committee);
- (iii) the nomination procedures and the process and criteria adopted by the nomination committee or the board of directors (if there is no nomination committee) to select and recommend candidates for directorship during the year;
- (iv) a summary of the work, including determining the policy for the nomination of directors, performed by the nomination committee or the board of directors (if there is no nomination committee) during the year; and
- (v) the number of meetings held by the nomination committee or the board of directors (if there is no nomination committee) during the year and the record of individual attendance of members, on a named basis, at meetings held during the year.

**(h) Auditors' remuneration**

An analysis of remuneration in respect of audit, audit-related and non-audit services provided by the auditors (including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally) to the listed issuer.

**(i) Audit committee**

The following information relating to the audit committee:

- (i) its role, function and composition of the committee members (including names and identifying in particular the chairman of the audit committee);
- (ii) the number of audit committee meetings held during the year and record of individual attendance of members, on a named basis, at meetings held during the year;
- (iii) a report on the work performed by the audit committee during the year, including its findings on review of the quarterly (if relevant), half-yearly and annual results, system of internal control, and its other duties set out in the Code; and
- (iv) details of non-compliance with rule 3.21 of the Exchange Listing Rules (if any) and an explanation of the remedial steps taken by the listed issuer to address such non-compliance relating to establishment of an audit committee.

*Note: Listed issuers are reminded of their obligation to comply with rule 3.21 of the Exchange Listing Rules. Failure to comply with such requirements constitutes a breach of the Exchange Listing Rules.*

## **CODE PROVISION DISCLOSURE UNDER THE CODE**

3. The Code sets out code provisions of the general management responsibilities of the board of directors. For ease of reference, the specific requirements pertaining to the code provisions under the Code which require disclosure by listed issuers are set out below:
  - (a) an acknowledgement from the directors of their responsibility for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.2 of the Code);
  - (b) report on material uncertainties, if any, relating to events or conditions that may cast significant doubt upon the listed issuer's ability to continue as a going concern (C.1.2 of the Code);
  - (c) a report that the board has conducted a review of the effectiveness of the system of internal control of the issuer and its subsidiaries (C.2.1 of the Code); and
  - (d) a detailed explanation of the audit committee's view and the reason(s) why the board has taken a different view from that of the audit committee regarding the selection, appointment, resignation or dismissal of the external auditors (C.3.4 of the Code).

## **RECOMMENDED DISCLOSURES**

4. The disclosures set out in this paragraph relating to corporate governance matters are provided for listed issuers' reference. They are not intended to be exhaustive or mandatory. They are rather intended to set out the areas which listed issuers may comment on in their Corporate Governance Report. The level of details needed varies with the nature and complexity of listed issuers' business activities. Listed issuers are encouraged to include the following information in their Corporate Governance Report:
  - (a) Share interests of senior management**
    - (i) the number of shares held by senior management (i.e. those individuals whose biographical details are disclosed in the annual report).

**(b) Shareholders' rights**

- (i) the way in which shareholders can convene an extraordinary general meeting;
- (ii) the procedures by which enquiries may be put to the board together with sufficient contact details to enable such enquiries to be properly directed; and
- (iii) the procedures for putting forward proposals at shareholders' meetings with sufficient contact details.

**(c) Investor relations**

- (i) any significant changes in the listed issuer's articles of association during the year;
- (ii) details of shareholders by type and aggregate shareholding;
- (iii) the number and identity of shareholders holding more than a 5% shareholding;

*Note: The disclosure must be in accordance with the requirements of Practice Note 5 of the Exchange Listing Rules.*

- (iv) details of last shareholders' meeting;
- (v) indication of important shareholders' dates in the coming financial year; and
- (vi) public float capitalisation as at the end of the year.

**(d) Internal controls**

- (i) where a listed issuer includes a report on the review of its system of internal control in the annual report pursuant to paragraphs C.2.1 of the Code, the listed issuer is encouraged to disclose the following details in such report:
  - (aa) an explanation of how the system of internal control has been defined for the listed issuer;

- (bb) procedures and internal controls for the handling and dissemination of price sensitive information;
  - (cc) whether the listed issuer has an internal audit function or the outcome of the review of the need for an internal audit function where the listed issuer has no such function;
  - (dd) how often internal controls are reviewed;
  - (ee) a statement that the directors have reviewed the effectiveness of the system of internal control and whether they consider the internal control systems effective and adequate;
  - (ff) criteria for the directors to assess the effectiveness of the system of internal control;
  - (gg) the period which the review covers;
  - (hh) details of any significant areas of concern which may affect shareholders;
  - (ii) significant views or proposals put forward by the audit committee; and
  - (jj) where a listed issuer has not conducted a review of its internal control during the year, an explanation why it has not done so; and
- (ii) a narrative statement (including the items under C.2.3 of the Code) of how the listed issuer has complied with the code provisions on internal control during the reporting period (C.2.3 of the Code).

**(e) Management functions**

- (i) the division of responsibility between the board and management.

## APPENDIX III

### COMMENTARY ON PROVISIONS IN THE UK COMBINED CODE NOT ADOPTED IN THE DRAFT CODE

1. The UK Combined Code includes recommended board practices relating to the evaluation of a board's performance, institutional investors, appointment of senior independent directors and the role of company secretary. Please see paragraphs 3 to 9 for a further discussion.
2. The draft Code represents a significant enhancement of the existing Code. We are concerned that adoption of the provisions above may create unintended effects. In particular it may discourage listed issuers from complying with the Code provisions and recommended best practices in the draft Code. Whilst it is desirable to bring our Code as closely into line with international standards as possible, we do not propose to include these provisions in the Code for the time being. We will reconsider these board practices together with further amendments to the Code in the light of market developments and experience gained after introducing the new Code.

#### *Evaluating performance of the board*

3. There is a provision in the revised UK Combined Code which deals specifically with performance evaluation. There are views that, whilst it may not be the right time to introduce the relevant recommendations as Code provisions, we should introduce them as recommended best practices. Most of the listed issuers in Hong Kong are family-owned and many boards are dominated by persons closely related to each other. Given the prevalence of this particular board structure, it does not appear to us to be practical to incorporate a requirement that the board formally evaluate its own performance at this stage of the Code's development.

#### *Institutional investors*

4. The UK Combined Code contains provisions regarding institutional investors that some regard as common sense advice. The provisions focus on three main areas, namely:
  - (a) dialogue with companies — institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives;

- (b) evaluation of governance disclosures — when evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention; and
  - (c) shareholder voting — institutional shareholders have a responsibility to make considered use of their votes.
5. Section E of the Code already deals with communication with shareholders including institutional investors. We do not consider it appropriate to include provisions relating to how institutional investors should evaluate governance disclosures of listed issuers as they are not under any obligation to disclose their assessment to other shareholders. The introduction of the Code already states that shareholders should perform their own evaluation of the corporate governance disclosures made by listed issuers. Like all other shareholders, institutional investors have a discretion to cast their votes and it is a matter for their underlying shareholders to challenge the use or non-use of their votes. The Exchange has no direct relationship with institutional investors and therefore we do not consider that it is appropriate for a code addressed to listed issuers and directors to govern how institutional investors make use of their votes.

***Senior independent director***

6. We do not consider the typical board structure in Hong Kong warrants the appointment of any senior independent directors. While most listed issuers in Hong Kong have controlling shareholders, it is not clear whether any additional benefit will be derived from such appointment.

***Role of company secretary***

7. The Code focuses mainly on the role of directors and management responsibilities of the board of directors. There are views that we should include in the Code 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.
8. There are views that including equivalent provisions in the Code would reflect the increasing importance, breadth and complexity of corporate governance issues for Hong Kong boards. It is argued that there is no-one better placed or qualified to advise and provide input on these issues than the company secretary, in particular, as the company secretary is an officer of the company and not merely an agent of the board or a member of subordinate management. Terms such as those in the UK Combined Code reinforce the standing of the company secretary.
9. We agree that company secretaries have an important role to play in promoting corporate governance standards. However, we do not consider that it is appropriate for the time being to set out responsibilities of other individuals, such as company secretaries, in the Code as to do so may lead to a perception that the responsibilities of directors can be shifted onto such individuals. We will give further consideration to this issue in our post-implementation review of the Code.

## **APPENDIX IV**

### **STATEMENTS OF POLICY ON PERSONAL DATA**

#### **PERSONAL INFORMATION COLLECTION STATEMENT**

This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which the Personal Data of respondents will be used after collection, what these respondents are agreeing to in respect of Hong Kong Exchanges and Clearing Limited’s (“HKEx”) use of their Personal Data and their rights under the Personal Data (Privacy) Ordinance.

#### **Purpose of Collection**

HKEx may use the Personal Data of respondents collected by HKEx in connection with this document for one or more of the following purposes:

- for performing HKEx’s functions and those of its subsidiaries under the relevant laws, rules and regulations
- for research and statistical purposes
- for any other lawful purposes

#### **Transfer of Personal Data**

Personal Data collected may be disclosed by HKEx to members of the public in Hong Kong and elsewhere, as part of the exposure exercise on this document.

## **Access to or Correction of Data**

You have the right to request access to and correction of your Personal Data in accordance with the provisions of the Personal Data (Privacy) Ordinance. If you wish to request access to and/or correction of your Personal Data provided in your submission on this document, you may do so in writing addressed to:

Personal Data Privacy Officer  
Hong Kong Exchanges and Clearing Limited  
11th Floor, One International Finance Centre  
1 Harbour View Street  
Central  
Hong Kong  
[cvw@hkex.com.hk](mailto:cvw@hkex.com.hk)

Hong Kong has the right to charge a reasonable fee for processing any data access request.

## **PRIVACY POLICY STATEMENT**

HKEx is firmly committed to preserving the privacy of respondents in relation to Personal Data supplied to HKEx on a voluntary basis. Personal Data may include names, addresses, e-mail addresses, login names etc. HKEx uses the information for the stated purposes when your Personal Data is collected. The Personal Data will not be used for any other purposes without your consent unless such use is permitted or required by law.

HKEx has security measures in place to protect the loss, misuse and alteration of the Personal Data of respondents. HKEx will strive to maintain Personal Data as accurately as reasonably possible and Personal Data will be retained for such period as may be necessary for the proper discharge of the function of HKEx and those of its subsidiaries.