The Hong Kong Institute of Chartered Secretaries

Online Submission:

Hong Kong Exchanges and Clearing Ltd (HKEX) Consultation Paper on Review of Corporate Governance Code and Related Listing Rules (2021)

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Date: 17 June 2021

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About HKICS

The Hong Kong Institute of Chartered Secretaries (the Institute) is an independent professional institute representing Chartered Secretaries and Chartered Governance Professionals as governance professionals in Hong Kong and the Mainland of China (the Mainland) with over 6,000 members and 3,200 students. The Institute originates from The Chartered Governance Institute in the United Kingdom with nine (9) divisions and over 30,000 members and 10,000 students internationally. The Institute is also a Founder Member of Corporate Secretaries International Association Limited (CSIA), an international organisation comprising fourteen (14) national member organisations to promote good governance globally.

Question 1 Do you agree with our proposal to introduce a CP requiring an issuer's board to set culture in alignment with issuer's purpose, value and strategy?

Unanswered.

We appreciate the Exchange's acknowledgement of corporate culture as being an important element of a corporate governance framework and the recognition that the board of a listed company has a role to play in relation to corporate culture.

However, we are not sure that the way to address this is to require an issuer's board to "set" culture, as culture cannot be codified. It is not a straightforward concept, capable of being precisely and succinctly disclosed in one page (to paraphrase paragraph 54 of the Consultation Paper), nor encompassed within four elements (paragraph 53). It is not something fixed, determinable and capable of a board decision - like, for example, "setting" a budget. In fact, culture is intangible, often tacit and unspoken, evolving to meet changing times and needs, adaptable and applicable to a myriad of daily events, relationships, challenges and opportunities. It is a collection of values, beliefs, behaviours, attitudes, mindsets, business and market environments and social patterns.

It is also unclear how compliance with this CP could be properly measured, rendering it incapable of being properly applied and enforced.

Perhaps instead, issuers could be asked to disclose how their boards have sought (in conjunction with the management team) (i) to understand the corporate culture of the issuer; (ii) to ensure alignment between the corporate culture and the issuer's purpose, strategy and values; (iii) to measure the corporate culture; and (iv) to align incentives and rewards to support and encourage behaviours consistent with the company's purpose, values, strategy. Such an approach might enable boards to understand the role they can and should play in relation to corporate culture and also lead to more meaningful disclosure, rather than simply a confirmation that the board has now determined that the issuer's culture should be "XXX".

Question 2 Do you agree with our proposal to:

(a) introduce a CP requiring establishment of an anti-corruption policy?

Yes.

We submit that the establishment of an anti-corruption policy and, more importantly, its faithful implementation is fundamental to good corporate governance. This will also enhance the reputation of Hong Kong as an international financial centre. Our Institute works with the ICAC in promoting anti-bribery practices to our members, stakeholders and the public and, as such, welcomes ICAC's support as indicated under paragraph 61 of the Consultation Paper.

We also submit that the guidance under paragraph 60 of the Consultation Paper will be useful to issuers. We have a specific Ethics, Bribery and Corruption Interest Group which includes a representative from the ICAC, and may be able to contribute perspectives on the topic. One point that we would like to add is that, in certain markets or jurisdictions where issuers carry on business there may already be legal provisions concerning corruption. The Exchange's guidance must be subject to those overriding obligations where they exist.

(b) upgrade a RBP to CP requiring establishment of a whistleblowing policy?

Yes.

Our Institute has promoted this topic for a number of years. Whistleblowing serves as an important mechanism for issuers to learn of issues and to manage them, as part of risk mitigation. A well-implemented whistleblowing system is therefore of significant and practical governance value. A properly designed whistleblowing policy should also contain protections for the whistleblower against retributions, and other matters noted in the Consultation Paper.

We also submit that the guidance under paragraph 60 of the Consultation Paper would be useful to issuers. One point that we would like to add is that, in certain markets or jurisdictions where issuers carry on business, there may already be legal provisions concerning whistleblowing. The Exchange's guidance must be subject to those overriding obligations where they exist.

Question 3 Do you agree with our proposal to introduce a CP requiring disclosure of a policy to ensure independent views and input are available to the board, and an annual review of the implementation and effectiveness of such policy?

Unanswered.

The Consultation Paper appears to be referring to two aspects of independence: independence of an individual director from other influences (connection with a family shareholder or professional advisor, etc.) and independence of directions from the company. The reasoning for the proposal discusses the former, but the proposal of the Consultation Paper appears to relate to the latter.

Boards are not independent and every director, including the "independent" directors, is there to serve the company. It is not their job to ensure that the views and input of others, beyond the board, are tabled with the board. Their job is to present their own views and inputs.

To ensure that those views and inputs are independent of the undue influence of other relationships and considerations, the Exchange has developed and greatly expanded the role and importance of independent non-executive directors. That is the route by which "independent views and input are available to the board".

Also, we do not see how this issue can be addressed by a "policy", which could simply say something along the line of: 'We ensure independent views and input are available to our Board through our INEDs and other channels…'

Question 4(a) Do you agree with our proposal regarding re-election of Long Serving INEDs to revise an existing CP to require (i) independent shareholders' approval; and (ii) Additional Disclosure?

Unanswered.

The objective of the proposal should be the promotion of a balanced board with the right mix of skills and experience. A balanced board is in the interests of the company and all its shareholders, major or otherwise. And a balanced board is one which includes, amongst other areas of individual differences, a mix of long-serving and more recently appointed directors. No one would suggest that the management of a company would best be entrusted to a senior executive team which did not have a considerable measure of experience and knowledge of the business. Equally, no one should expect the oversight of the business and its management to be entrusted to a board which was not allowed to possess and retain a similar level of experience and knowledge.

Against this background, proposal 4(a)(i) sits uncomfortably with two basic principles of shareholder rights and board responsibilities:

- This proposal moves towards creating two classes of shares - those held by 'independent' shareholders and those which are not. Unless there is a compelling reason for doing otherwise, such as a conflict of interest in a connected transaction, all shares should have the same rights. This includes the right to vote on directors' appointments.

- All directors owe a similar duty to the company and all its shareholders. A provision which requires certain directors to be appointed by only certain shareholders cuts across this. Boards function collectively and collegially, not by factions.

Question 4(b) Do you agree with our proposal to introduce a CP requiring an issuer to appoint a new INED at the forthcoming AGM where all the INEDs on the board are Long Serving INEDs, and disclosing the length of tenure of the Long Serving INEDs on the board on a named basis in the shareholders' circular?

Yes.

We agree that the board of an issuer should be refreshed with the perspectives of a fresh INED where all INEDs are Long Serving Directors (under proposed CP B.2.4). This is especially so given the statistics stated in paragraph 67 of the Consultation Paper.

The information as to the name and length of tenure of a named director can be collated from public announcements and, as such, and we see no issue with requiring disclosure of the information under the shareholders' circular. This will facilitate access to the information by shareholders in the interest of transparency.

Question 5 Do you agree with our proposal to introduce a new RBP that an issuer generally should not grant equity-based remuneration (e.g. share options or grants) with performance-related elements to INEDs as this may lead to bias in their decision-making and compromise their objectivity and independence?

Unanswered.

The starting principle is that, in overall terms, the interests of directors should be aligned with those of the shareholders, who appoint them and whose interests they are tasked to safeguard. In that spirit, INEDs should be encouraged to hold shares, as do those who appoint them and to whom they are answerable. That is the position in Australia. They should be encouraged not to have share options or the like, because the people who appoint them do not have those either.

In a similar vein, equity-based remuneration is intended to encourage certain behaviours and reward certain outcomes. That may be appropriate when it comes to executive conduct and performance, especially since the remuneration schemes are approved and overseen by the board. It is, however, quite different for the board itself. It could influence its oversight of the executive remuneration schemes as well as its own decision-making at board level.

In any event, this proposal should really be considered in the wider context of INEDs' remuneration. Whilst appropriate in itself, this proposal should really be accompanied by a further measure to ensure that INEDs are properly paid for the work they do, the responsibilities they bear, and the potential liabilities they incur.

Question 6(a) Do you agree with our proposal to highlight that diversity is not considered to be achieved by a single gender board in the note of the Rule?

Unanswered.

The note to MB Rule 13.92 states that an issuer is not considered to have achieved diversity for a single gender board, but the rule only relates to the need to adopt a diversity policy. When read with the proposed changes to Principle B.1. where the board should have a 'balance of skills, experience and diversity', the note may have the unintended effect, as an unqualified interpretative note, for a finding of an immediate breach of Principle B.1. However, a breach of Principle may not amount to a breach of a CP. But then, there is also CP B1.3, and does it mean that where there is a single gender board, a

listed company should say its board diversity policy is not effective under its review? Perhaps, this is a drafting issue which could be resolved by adding that there should be a three-year transition period under the note to MB Rule 13.92. Please kindly consider.

Turning to the proposal, we submit that there should be a voluntary target for 30% WOBs by 2026. This will be in line with our Institute's call, under a review report, titled 'Missing Opportunities? A Review of Gender Diversity on Hong Kong Boards' (Review), which should be taken to be incorporated into and forming part of this submission:
https://www.hkics.org.hk/publication_details.php?menu_id=6&sub_menu_id=94&nid=2462

To explain further:

- The clear implication of paragraph 88 of the Consultation Paper and the wordings of questions 6(a) and (b) is that the Exchange considers that an issuer could achieve diversity with the appointment of a single 'director of the absent gender', which is, of course, a code for women, since there are no all-female boards. This falls short of promoting the level of diversity required to give rise to an effective board. On the contrary, it could serve to promote the 'one and done' phenomenon which has been observed in other jurisdictions. That is, we are concerned that the Exchange's proposal could lead to some issuers, with more than one woman on board (WOB), to backtrack and have only one WOB. This consequence, while unintended under the Consultation Paper, is not a fanciful risk. This is because there is simply a floor being set as to a minimum should be the position. It could lead to a race to the bottom.

- Moreover, this approach has been observed to deter strong and capable women from accepting board appointments, due to an understandable perception that the invitation to serve amounts only to 'tokenism' and that the culture of the board will not be welcoming or conducive to the expression of a diverse voice. Experience elsewhere also indicates that women prefer to serve on boards where there is already a meaningful representation of women or a clear commitment to achieve that within a near timeframe.

Instead, we call, under the Review, for a 30% voluntary target, with a six-year transition period, which will deal with the perceived issue of the existence of a sufficient pool of qualified female director candidates, and, a 'comply or explain' regime, both during and after the transition period. Issuers that do not comply could be obliged to disclose the specific reasons for this and the steps they intend to take to achieve compliance. This is similar to the UK position.

Our call is supported by: BlackRock; Freshfields Bruckhaus Deringer; The Women's Foundation; 30% Club; Brunswick Group; Community Business; New World Development Company Limited; Egon Zehnder; BCT Group (BCT Financial Ltd & Bank Consortium Trust Co Ltd); Link Asset Management Limited; along with The Honourable Mrs Fanny Law Fan Chiu-fun GBM GBS JP, Non-official member of the Executive Council of The Government of the Hong Kong Special Administrative Region (in her personal capacity); and Dr Adrian Cheng JP, Chief Executive Officer, New World Development Company Limited; Founder & Chairman, K11 Concepts Limited; Owner of Rosewood Hong Kong; Executive Director, Chow Tai Fook Jewellery Group Limited; Vice-Chairman and Group CEO, CTF Education Group, and others.

The importance of board diversity is identified under paragraph 84 of the Consultation Paper. In fact, the issue goes much deeper. If the most obvious aspect of diversity, gender, is so skewed, as set out in

the near bottom position of Hong Kong under the Report, how can it realistically be expected that other aspects of diversity be properly addressed?

From the above, we submit that there should be the adoption of a voluntary target of 30% WOBs within 6 years as set out above, with a comply and explain regime in the form of an additional RBP for adoption as a CP over time.

Question 6(b) Do you agree with our proposal to introduce a MDR requiring all listed issuers to set and disclose numerical targets and timelines for achieving gender diversity at both: (a) board level; and (b) across the workforce (including senior management)?

Unanswered.

Our Institute welcomes the introduction of numerical targets and timelines, including for senior management, as well as some guidance in relation thereto. Whilst we agree, therefore, with the spirit of the Exchange's proposal, we disagree with the failure to provide clear requirements, or even guidance, as to either the targeted level of diversity or the time in which that is to be achieved beyond the aspirational statements under the Consultation Paper. As framed, a target of a single female appointment over an extended period of time would meet the MDR. Nor would there be any consequence for non-compliance. Indeed, the targets and timelines could simply be reset to lower objectives. As set out under our answer to question 6(a), a three-year transition period should be included under the note to MB Rule 13.92. Also, as set out in our Review, and our answer to question 6(a), we support 30% female representation on boards to be achieved over a transitional period of 6 years, as a minimum, as an additional RBP.

In terms of the disclosure of gender diversity across the workforce as a whole, we are concerned that such disclosures might not be meaningful or insightful unless they are accompanied by a detailed breakdown of gender across pay grades, occupations, workplaces and staff grades. We tend, therefore, to think that meaningful gender diversity targets and achievements at a leadership level are more important and will lead to a better gender balance across companies as a whole.

Question 6(c) Do you agree with our proposal to introduce a CP requiring the board to review the implementation and effectiveness of its board diversity policy annually?

Unanswered.

In itself this proposal is acceptable. Board oversight of the implementation of its diversity policy is welcome, provided this is accompanied by disclosure of the outcome of that review, including reasons for failure and measures to correct this.

However, in the context of HKEX's proposals as a whole, this proposal is of limited value. To be effective, this proposal should require that:

- The policy which is being reviewed is specific, substantive and promotes meaningful diversity; and

- The review needs to be undertaken by a board which itself is diverse or on a clear pathway to diversity.

Question 6(d) Do you agree with our proposal to amend the relevant forms to include directors' gender information?

Yes.

This would be good for statistical purposes. However, there could be sensitivities. For example, for transgender persons, would they be allowed to claim the gender they prefer? Please kindly consult the Equal Opportunities Commission prior to finalising any proposal.

Question 7 Do you agree with our proposal to upgrade a CP to Rule requiring issuers to establish a NC chaired by an INED and comprising a majority of INEDs?

Yes.

Our Institute submits that the NC is important for the reasons set out in paragraph 92 of the Consultation Paper, and therefore the upgrade from a CP to a Rule is in the interests of good governance given the importance of the work of NCs. It is also a good balance between the US position where all members of the NC are INEDs, and the Australia, Singapore, and UK positions where there is only a 'comply or explain' regime with the NC having a majority of INEDs, instead of a strict rule requirement.

We also welcome the guidance on expected disclosures regarding INED nomination and appointments, including channels in searching for appropriate INEDs, and the potential contributions the candidates would bring to the board. International investors are concerned with the qualifications, skills and experience of INEDs, as suggested in paragraph 94 of the Consultation Paper.

We agree that this upgrade would enhance transparency and the independence of the INED nomination and appointment process to promote better practices and standards as referred to in paragraph 95 of the Consultation Paper.

Question 8 Do you agree with our proposal to upgrade a CP to a MDR to require disclosure of the issuer's shareholders communication policy (which includes channels for shareholders to communicate their views on various matters affecting issuers, as well as steps taken to solicit and understand the views of shareholders and stakeholders) and annual review of such policy to ensure its effectiveness?

Yes.

However, in line with the discussions in paragraphs 97 to 100 of the Consultation Paper, should the reference be 'shareholders' and stakeholders' communication policy? If this is the case, under the

proposed MDR L.(b) perhaps the better terminology is shareholders and stakeholders' communication policy. Also, any communication should also be with 'relevant' stakeholders.

Question 9 Do you agree with our proposal to introduce a Rule requiring disclosure of directors' attendance in the poll results announcements?

Yes.

We have no issue with the proposed Rule 13.39(5A) as the information could easily be included within the poll results announcement.

Question 10 Do you agree with our proposal to delete the CP that requires issuers to appoint NEDs for a specific term?

Yes.

We have no issue with the specific term deletion.

Question 11 Do you agree with our proposal to elaborate the linkage in the Code by (a) setting out the relationship between CG and ESG in the introductory section; and (b) including ESG risks in the context of risk management under the Code?

Yes.

We welcome the linkage under the last paragraph of the 'Introduction' of the Corporate Governance Code, and related changes to Principle D.2, and CP D.2.2, and D.2.3(a) and (b). We had, under earlier submissions noted that the ESG Guide is more about ES and the G is under the Corporate Governance Code. This is now clarified under the proposed changes.

Question 12 Do you agree with our proposal to amend the Rules and the ESG Guide to require publication of ESG reports at the same time as publication of annual reports?

Yes.

Question 13 Do you have any comments on how the re-arranged Code is drafted in the form set out in **Appendices III** and **IV** to this paper and whether it will give rise to any ambiguities or unintended consequences?

Yes.

We submit that the alignment is appropriate.

As the Exchange notes, the CG Code has undergone rounds of amendments and now comprises 16 Principles, 78 CPs and 10 RBPs. This compares with a much simpler document when the Code was first introduced.

As we have remarked elsewhere, more is not necessarily better and indeed, in some cases, less can be better.

The trend towards more and more CPs, covering more and more issues, runs counter to a basic principle of good corporate governance practice, which is that 'one size does not fit all'. This might not matter if issuers availed themselves of the entitlement to digress and explain but, in practice, most issuers rigorously follow the Code, or say they do. The latest HKEX review showed almost all issuers reported compliance with almost all CPs, which may indicate an element of box-ticking, unless the Code provides a governance framework which fits everyone, which is unlikely.

One risk of this approach is that shareholders and other stakeholders can no longer make informed judgements about the quality of an issuer's corporate governance, still less how it compares to that of its peers.

In response, the Institute would suggest:

- That in future Code revisions, the Exchange should give thought to removing provisions which are either not working or which are unnecessary.

- A greater focus by the Exchange on monitoring the quality of disclosure, which is a challenge articulated in para 134 of the Consultation, as opposed to mandating its scope, with the focus being on whether such disclosure is true, meaningful, valuable and corresponds to what the issuer actually does and which is good for the company and its stakeholders.

Question 14 In addition to the topics mentioned in this paper, do you have any comments regarding what to be included in the CG GL which may be helpful to issuers for achieving the Principles set out in the Code?

Please refer to our answer to Question 13.

There will also be need to consider the work of the IFRS Foundation in working towards consistency in ESG standards, and developments as to the assurance of ESG reports and to make appropriate changes to support the initiatives.

Question 15 Do you agree with our proposed implementation dates of:

(a) for all proposals (except the proposals on Long Serving INED): financial year commencing on or after 1 January 2022; and

Yes.

(b) for proposals on Long Serving INED: financial year commencing on or after 1 January 2023?

Yes.