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GUIDE for

Independent Non-Executive

directors

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ABOUT THE PUBLISHER

The Hong Kong Institute of Directors ("HKIoD") is Hong Kong's premier body representing professional directors working together to promote good corporate governance and to contribute towards advancing the status of Hong Kong, both in China and internationally. A non-profit-distributing organisation with membership consisting of directors from listed and non-listed companies, HKIoD is committed to providing directors with educational programmes and information service and establishing an influential voice in representing directors. With international perspectives and a multi-cultural environment, HKIoD conducts business in biliteracy and trilingualism.
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INTRODUCTION

Developed with the Hong Kong Independent Non-Executive Director in mind, particularly those directors who sit on the boards of Hong Kong listed companies, this Guide fills a need for concise, user-friendly guidance where until now relevant information had to be gleaned from more general works relating to the role of directors.

The challenges faced by Hong Kong's independent directors grow out of a corporate governance setting where boards typically are controlled by the founding family or otherwise dominated by a close-knit shareholding group, where the presence of independent directors on the board is mainly the result of the Listing Rules of The Stock Exchange of Hong Kong Limited and where directors in these positions because of legal and business realities often question whether they are adding any value or feel powerless to voice contrary opinions or effect positive change.

The challenge for Hong Kong's independent directors is to operate in this environment and yet provide the value for which independent directors are sought. This Guide in a concise format aims primarily to help directors understand their role as an independent voice on the board and the responsibility, authority as well as the limitations that role carries with it. Armed with such understanding it is hoped that independent directors in Hong Kong will take on the challenge posed with greater vigor and confidence.

Having explained the aim of this Guide, it should be said what this Guide is not. This Guide does not aim to establish rules or best practices to be followed by the board of directors or provide a road map through legislative and regulatory provisions relating to directors or provide guidance on how directors should handle specific situations that might arise - although it also should be said that there is an element throughout this Guide of each of these aspects as they relate to Independent Non-Executive Directors.

It is recommended that this Guide be read in conjunction with The Hong Kong Institute of Directors' *Guidelines for Directors* which provides a detailed review of the role and duties of directors in general.

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INDEPENDENT NON-EXECUTIVE DIRECTORS

A Non-Executive Director is a director who has no executive or management responsibility in the company on whose board he sits. He is deemed independent under the Listing Rules of The Stock Exchange of Hong Kong Limited if he is independent of management and does not receive any benefits from the company other than his director's fee.

Independence, however, is more than a checklist with all the boxes ticked. Independence for these purposes is an attitude that reveals itself in an enduring sense of professional duty even under or rather especially under pressure. It's axiomatic, and it's the law, that every director must act towards his company at all times with honesty, integrity and candor and use due care, skill and diligence in the course of taking any action affecting the company.

This formula is repeated so often, some directors take it for granted and neglect to consider or ignore the sometimes troubling implications that concepts like integrity, care and diligence could have if applied with rigor at the next board meeting. An Independent Non-Executive Director cannot be so lax for these are the concepts that form the foundation of his professional duty and therefore his independence.

An independent attitude is not arrogance or a need to be different or to find divergence. It is not being uncooperative, disruptive or loud, and it is not being suspicious or critical for the sake of putting on a good show. One can be independent and remain a constructive member of the board (which is not to suggest that board harmony is the goal).

A director possesses an independent attitude if he is aware of and understands the interests around him but remembers that his actions and his vote are in the service of the duty he owes to the members of the company as a whole and not a particular interest. So long as he acts in good faith and with integrity a director will possess an independent frame of mind in addition to generally fulfilling his duty as a director. (N.B. There are certain occasions when the Independent Non-Executive Director is called on specifically to protect the interests of minority shareholders. This is briefly discussed in the guidelines that follow.)

BASIC GUIDELINES

1. ROLE OF THE INDEPENDENT NON-EXECUTIVE DIRECTOR

As an Independent Non-Executive Director your role is or will be to supervise management, participate in the direction of the company's business and affairs and speak out firmly and objectively on these and other issues that may come before the board. In fulfilling your role, one of your essential responsibilities is or will be to help ensure that the interests of all shareholders, and not only the interests of a particular faction or group, are taken into account by the board. There are exceptions to this rule where certain transactions such as takeovers, spin-offs and other substantial transactions, share repurchases by the company or connected transactions are involved and due to a conflict of one or more of the directors on the board discharge of the board's responsibilities is required to be carried out by an independent committee of the board. In these situations the independent committee is charged with generally protecting the interests of the independent shareholders being those shareholders having no interest in the transaction other than their interest as a shareholder of the company.

More detailed guidance can be found in the Listing Rules of The Stock Exchange of Hong Kong Limited and the Hong Kong Codes on Takeovers and Mergers and Share Repurchases.

2. YOU MUST DEVOTE SUFFICIENT TIME

Before accepting an appointment to the board you must acquire a realistic appreciation of the time that will be necessary to devote to board matters and then decide whether you will have sufficient time to meet your new responsibilities. You cannot give board matters the attention they require if you do not have the time to learn about the company and the industry it is in, to attend regularly scheduled board meetings and to review and consider prior to board meetings all papers and materials that are relevant to the matters to be considered at the meeting.

3. THE APPOINTMENT PROCESS

On becoming a director you are accepting significant legal responsibilities. Do not accept these lightly. Prior to accepting an appointment you should be informed about how the board you have been asked to sit on is organized and operates. You should try to meet each member of the board and understand the personality and dynamics of the board as a whole. Ask yourself if the board serves as a rubber stamp for the company's

controlling interests, or is it politicized and divided by diverse shareholder interests, or is it organized and operating professionally with mutual understanding and respect among fellow board members. You should also seek to identify the major challenges the company faces and the strategic and commercial issues that the company will need to address in order to meet those challenges.

With this background in mind you need to consider how you will fit in and what you can add as a member of the board. The board will be doing its job thoughtfully if it has thought through these same issues and if the person it seeks to appoint is recruited against a full specification stating clearly the board's expectations regarding the role of the Independent Non-Executive Director it seeks to appoint. You should be comfortable that the board has thought seriously about the role of the independent director and that you understand the board's expectations in that regard prior to accepting appointment. Conditions of appointment, including as regards tenure and remuneration, would normally be set out in the written appointment letter.

4. INDEPENDENCE

Independence is a state of mind and only you will know upon reflection in good faith whether you can or will act independently. At a minimum independent judgment is judgment formed after a fair consideration of all relevant information available and made free from the influence of your personal interests whether direct or indirect. You will need to be honest with yourself in answering whether motives of personal gain, no matter how derived or in what form, will interfere with the exercise of your judgment.

This subjective test if taken with the best of intentions is probably the only real test of whether you are or will be actually independent. Of course, there are tests of independence which purport to be objective and are effective at dealing with the appearance of independence or the lack of it. Examples of these tests can be found in Rule 3.11 of the Listing Rules of the Stock Exchange of Hong Kong Limited and Rule 2.8 of the Hong Kong Code on Takeovers and Mergers. These tests generally concern the existence of certain personal and professional relationships, direct and indirect interests in businesses related to the company on whose board one sits, and the significance or importance of such interests to one's own business or situation.

5. CONFIDENTIALITY AND DISCLOSURE OF INTERESTS

Confidential information and matters of the company learned in your capacity as a director should be treated as such and not divulged to a third party without the authority of the company. All interests should be disclosed to the board and you should refrain from voting on such matters in which you have declared an interest. This is of particular importance in a cross-directorship situation.

6. KNOW THE COMPANY AND ITS BUSINESS

As a Non-Executive Director, your knowledge of the company and its business will be less than that of the Executive Director. This is not a negative as relevant experience may be complementary experience as well as experience gained in the same or similar industry. Nevertheless to make an informed judgment and in order to be effective during board deliberation of strategic and commercial issues, time must be spent learning about the company, its business, its competitors and the environment in which it operates. Companies will often organize some form of induction for the newly appointed board member that will ideally cover all these areas.

7. SUPERVISING MANAGEMENT

The board has a responsibility to supervise management. The board is ultimately responsible for ensuring that management and the company are conforming to established policies, procedures and plans. As an Independent Non-Executive Director you can and should play one or more roles in ensuring conformance. The role(s) you play may come naturally depending on your personality, temperament, experience and background. Your contribution may be in the form of simply being trusted to provide an objective point of view. You might, however, take on a more inquisitive role questioning assumptions and challenging the board to see issues in a new or different way. Service on board committees, such as the audit committee, is another way to contribute to the supervision of management. Finally, you will find that with sufficient trust and respect of your fellow members you might effectively serve as a confidante or sounding board to other members of the board creating understanding where needed. These are some of the main roles you may play and are by no means the only roles possible.

8. CONTRIBUTING TO THE COMPANY'S PERFORMANCE

The board is responsible for the company's commercial performance. To meet this responsibility the board focuses on formulating strategy and making policy and sets the direction of the company and its business. As an Independent Non-

Executive Director you will contribute to the performance function of the board through active participation on the board and by bringing your general and/or specialist knowledge, your experience, expertise, insights and your access to relevant outside information and/or outside personal and professional contacts to bear on the issues facing the board.

9. STRATEGY

The responsibility for a longer term of view of the company's outlook is normally carried out through a strategic thinking process leading to the formulation of strategic plans. This includes either a market based approach to analyzing the company's performance versus the markets over the long term and undertaking an external environment analysis followed by an internal SWOT analysis which helps to develop strategies and plans. The strategic thinking, based wholly on the available information, is an interactive process that leads to a vision shared by the directors and top management of possible futures for the enterprise. It involves a creative act. The creative responsibility lies with the board and top management to determine the appropriate direction of the company.

10. POLICY

Corporate policy is the guidance determined by the board to keep business plans and executive decisions consistent with corporate strategies. A company will need strategies in all of its principal areas of executive decisions. These will include, for example, policies in marketing, customer relations, product development, procurement and operation, finance, personnel, investor relations, social responsibility and so on, reflecting the nature of the organization.

Each of these broad policy areas will have a range of subordinate policy. For example, a firm might have a set of marketing policies with guidelines and constraints in pricing, quality, product safety, competition, advertising, etc, while the HR policies may include pay, employee benefits, reimbursement to expenses, terms of employment, security, pension arrangement etc.

Broad policy issues will come to the board for at least confirmation and possibly for a major input determining upon the board structure and style. Policies will be written and may be published as manuals. It is important that they are reviewed periodically to ensure that they are still in line with the strategic direction of the company.

11. BEING EFFECTIVE

Your effectiveness as an Independent Non-Executive Director in both the conformance and performance roles will depend on a number of factors such as the board's expectations and

its view of your role, your skills, training and knowledge and the type or style of the board on which you sit.

To be effective is a process that starts with careful attention paid to the appointment process and honest reflection on your ability to be independent and to devote the time needed to learn the company's business and to prepare and participate in meetings of the board. As a member of the board, you must identify how you might help the board fulfill its responsibility both for ensuring conformance with policies, procedures and plans and for reaching the performance requirements it has set. To do these things you must recognize that the character of your role is not single-dimensional. You don't have to be the perennial "squeaky wheel" (although at times it may be important to be firm in your position to the point of insisting on a formal record of your views or in the worse case even resigning). You can be a facilitator, a bridge, a sounding board and you have value in the form of your knowledge, experience and expertise to contribute. You must always remain constructive and conduct yourself professionally. And of course, to be effective you must work to earn and keep the trust and respect of your fellow board members, without which it will matter not how right you may be.

12. AUDIT COMMITTEES

As an Independent Non-Executive Director of a company listed in Hong Kong, there is a likelihood that eventually you will be asked to sit on the audit committee which is now mandatory according to the Listing Rules of The Stock Exchange of Hong Kong Limited.

The Stock Exchange of Hong Kong Limited stipulates that audit committees should have written terms of reference that deal clearly with its authority and duties and have indicated that the principal duties of an audit committee should include the review and supervision of the company's financial reporting process and internal controls.

If invited to join the audit committee, again you must be satisfied that you have the time, skill, knowledge and expertise to carry out your duties (on which there is no lack of resources with which you should try to become familiar) and you should not accept the appointment lightly. As in being a board member, being a member of the audit committee carries heavy responsibilities and will involve substantial work and some specialized knowledge in the area of accounting. Once on an audit committee, you must perform your duties, as in the case with your regular duties as a board member, with due care and diligence.

Publications Available

at The Hong Kong Institute of Directors



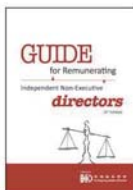
Guidelines for Directors is a desk-top and easy-to-carry reference book for both practising directors and newly appointed directors. It summarizes the law and recommends good practices in areas into which the law has not yet reached.



Guidelines on Corporate Governance for SMEs in Hong Kong serves as a tool for SME directors in securing strategic directions, business development and internal control. It provides SMEs with guidelines in five categories of companies varying in scale of operation. It also addresses issues of family companies and integration of management practices with governance.



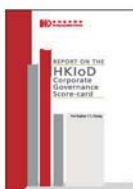
SME Corporate Governance Toolkit - From Guidelines to Implementation serves as a follow-up to the HKIOD guidebook, *Guidelines on Corporate Governance for SMEs in Hong Kong* ("Guidelines") to facilitate SMEs in the implementation of corporate governance practices. While the Guidelines address the "what-to-do" aspects of corporate governance practices, the Toolkit covers the "how-to-do" steps of implementation. It is recommended that both the Guidelines and the Toolkit are read as complementary reference tools for SMEs.



Guide for Remunerating Independent Non-Executive Directors provides companies with guidelines and assistance in engaging and remunerating INEDs with fair compensation packages, which together with appropriate motivation, enable INEDs to fulfill their responsibilities on the board, particularly from an independent perspective.



Guide for Independent Non-Executive Directors is a pocket guide that complements the *Guide for Remunerating Independent Non-Executive Directors* and helps INEDs understand their role as an independent voice on the board and the responsibility and authority the role carries with it.



Report on the HKIOD Corporate Governance Score-card documents findings of a survey on corporate governance practices of listed companies that are Hang Seng Index constituents, based on these companies' annual reports. It serves the purposes of raising community awareness, establishing benchmarks relevant to the Hong Kong financial market and compatible with international standards and helping Hong Kong companies to enhance corporate governance.

For more information: <http://www.hkiod.com>