

# What to Expect from INEDs

INEDs play an important role in enhancing the standards of corporate governance at a listed company, guarding against conflicts of interest, assisting with oversight of internal controls and risk management and acting as a catalyst for ESG adoption.

Listing Rules stipulate that listed companies must appoint INEDs to at least one third of board seats, with a minimum of three INEDs required. Directors, whether executive or non-executive, are subject to the same legal duty under the law and the Listing Rules, and are collectively and individually responsible for the management and operations of a listed company.

## INEDs in practice

### 1. General principles



#### Appointment

Before appointment, an INED candidate should learn, preferably through meeting the chairman, other board members and the CEO, about how the board is organised and operates, the major challenges and issues faced by the company, expectations of INEDs and how they may fit in and add value.

Both listed and non-listed companies can benefit from having outside directors on the board. Engaging INEDs on the board at least one year ahead of filing the Listing Application Form will strengthen board dynamics during IPO preparation and enhance the company's track record of corporate governance.



#### The board's collective roles

The board is ultimately responsible for corporate governance. All directors, including EDs, non-executive directors (NEDs) and INEDs, bear equal responsibility for fostering the company's long-term success. Collectively, the board is responsible for supervising management, directing the company and accountability.

It is axiomatic that every director must act towards the company with honesty, integrity and candour and exercise due care, skill and diligence. While serving from an independent perspective, INEDs should participate in the board as a contributing team member.

“Today's INED act as a catalyst for ESG adoption by the board and company. Their successes include ensuring ESG subjects are regularly on the board's agenda, promoting extensive in-company training and applying ESG initiatives to daily operations.”

#### Dr. The Hon Moses Cheng Mo-chi

Founding Chairman of The Hong Kong Institute of Directors



### **Independent checks and balances**

The independence of INEDs is defined by regulation in relation to material interests in business activities or significant links. In addition, independence is an attitude that reveals itself in addressing the company’s business and affairs with an objective perspective and independent judgment, free from the influence of any interests. One can be independent and remain a supportive member of the board by maintaining critical but constructive objectivity.

Exercising checks and balances from an independent perspective, INEDs must ensure the interests of all shareholders, and not only the interests of a particular faction or group, are considered by the board. There are, however, exceptions to the above in transactions, such as takeovers, spin-offs, connected transactions and where INEDs serve on an independent board committee charged with protecting the interests of independent shareholders.



### **Devoting sufficient time**

An INED must be able to afford to devote the time realistically required to familiarise themselves with the company, attend board and committee meetings, review board papers and relevant materials prior to meetings and communicate with the board chairman and management on significant matters.

An INED must exercise judgment to avoid overboarding. Although INEDs appointed to more than six boards must explain how they have the necessary time available to devote to each one, INEDs on fewer boards should also make an honest personal assessment of their time.



### **Education on evolving governance**

INEDs should keep up to date with evolving governance and learn how to stimulate board discussions on issues such as enhancing governance standards (noting investors are ready to pay a premium for good governance). They should put equal emphasis on conformance and performance, as well as understand the rise of ESG reporting and the expansion of shareholder rights, along with the growing importance of institutional investors. Continuing education and training help to both empower INEDs in their roles and enlighten other board members and management on how best to work with INEDs.



### **Interest segregation**

As an INED may have many outside interests, it is pertinent and necessary to disclose all relevant interests to the board and refrain from discussing and voting on matters with actual and potential conflicts of interest.



## 2. Practical aspects



### Participating effectively

INEDs can add value to the board through being inquisitive in questioning assumptions and motivating the board to see issues in a new or different way. They can also provide input from general and/or specialist knowledge and outside information. INEDs can assume multi-dimensional roles, such as facilitator, catalyst, sounding board, and networker.



### Risk management

INEDs are well positioned to address enterprise risk management from both an insider and an outsider perspective. Risk management calls for the careful review of risk strategy, including risk appetite, risk governance and culture, risk assessments, mitigation and monitoring. Risk management also involves examining the effectiveness of the three lines of defence: the functions that own and manage risk, the functions that oversee or specialise in risk management and the functions that provide independent assurance, i.e. internal audit, while the risk list covers financial risks, operational risks and reputational risks.



### Scrutinising internal control

INEDs should make sure a robust system of internal control is in place to ensure the company's operational effectiveness and efficiency, reliable financial reporting and compliance with laws and regulations. In particular, INEDs should exercise scrutiny over the internal controls that prevent, detect and correct errors and irregularities.

INEDs should also ensure the proper functioning of internal audit, performed by internal staff or an external professional adviser. Internal auditors report independently to the audit committee and/or board, not management, to assist in oversight of the company's system of risk management and internal controls.



### Shareholder relations

INEDs also play an important role in shareholder relations. It is an INED's duty to attend general meetings to understand their concerns and issues. INEDs should exercise due care in reviewing the company's announcements and reports to shareholders before publication. They are also at times required to meet investors, particularly on occasions of special transactions.

“ INEDs play a significant role by acting independently, guarding against conflicts of interests and ensuring proper corporate conduct. In contributing to shaping overall development, INEDs must be seasoned in assessing the business landscape and risks, particularly when the company engages in a major transaction or explores a new line of business. ”

#### Dr. David Wong Yau-kar

Past Deputy Chairman of The Hong Kong Institute of Directors



## Sustainability

Corporate sustainability is communicated through ESG reporting, which is an evolving practice. INEDs should champion the ESG cause to the board, promoting board leadership in ESG adoption and ensuring management takes it to heart.

INEDs may draw the board's attention to the drivers for ESG adoption, such as opportunities for operational efficiency, new products and innovation, enhanced risk management, talent attraction and retention, rapid growth of green bond market and sustainability indices, and improved reputation.

The board's checklist for ESG implementation should include environmental impact and green policy, stakeholder issues covering supply chain conformance, employee relations, product responsibility, as well as anti-corruption measures. INEDs should be alert to the "materiality", "quantitative", "consistency" and "balance" principles in ESG reporting.



## Working on key committees of the board

The key committees where INEDs play a pivotal role are the audit committee, nomination committee and remuneration committee, all of which should be composed of a majority of INEDs<sup>4</sup>.

INEDs should interact in meetings with management, the external auditor, internal auditor and external consultants. Private meetings of the audit committee with auditors are convened not only according to regular schedules but also when the need arises.

INEDs should ask for further management reports when the need arises, for clarification and as a basis for decision-making. They also have the prerogative to initiate independent studies of special issues through engaging external advisers.



## Working on the ESG committee of the board

An ESG committee, though not mandatory, helps a listed company ensure its ESG implementation is keeping pace with external trends. INEDs may add value to the board by taking an active part in ESG committee.



<sup>4</sup> Listing Rule requirements

- Audit committee: composed of NEDs only, majority INEDs, chaired by INED.
- Nomination committee: majority INEDs, chaired by INED or chairman of the board.
- Remuneration committee: majority INEDs, chaired by INED.

### 3. Working with INEDs

In a two-way relationship, EDs, NEDs and management should ensure that INEDs are included, integrated, motivated, empowered and able to work. The board chairman should take the lead in cultivating the right attitude and work relationship with INEDs. The board chairman should also conduct private sessions, apart from the mandatory annual session, with INEDs to discuss major issues and any concerns.

The company should offer reasonable remuneration and coverage of Directors and Officers Liability Insurance to INEDs, as well as arranging for their induction, continuing education and updates on directors' duties.



INEDs should be given reasonable time to review papers before meetings and have significant reports before they are announced. Management should also proactively communicate with INEDs, giving timely alerts about crises and briefings on significant issues and new proposals.

The company should invite INEDs to participate in major events and stakeholder engagements, and provide INEDs with independent professional advice upon special circumstances and as requested by INEDs, at the company's own expense.

It takes the whole board and management, working together, to realise the value of INEDs.

“Going forward, we will see a paradigm shift in INED's focus to include both financial and ESG performance, and a move from independence to interdependence and interplay among INEDs, NEDs and EDs.”

**Dr. Kelvin Wong Tin-yau**

Past Chairman of The Hong Kong Institute of Directors



## Key takeaways

- INEDs play an important role in enhancing the standards of corporate governance at a listed company, guarding against conflicts of interest, assisting with oversight of internal controls and risk management and acting as a catalyst for ESG adoption.
- Continuing education and training help to both empower INEDs in their roles and enlighten other board members and management on how best to work with INEDs.
- INEDs play an important role in shareholder relations and have a duty to attend general meetings.
- INEDs play a pivotal role in the audit committee, nomination committee and remuneration committee.

## Acknowledgements

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