

Issued on: 18 June 2021

The Exchange's Consultation Paper
Review of Corporate Governance Code and
Related Listing Rules (April 2021)

In relation to the captioned Consultation Paper, The Hong Kong Institute of Directors has the following views and comments.

General comments

We welcome the Exchange's latest exercise to review and update the Corporate Governance Code and related Listing Rules. We may not agree with every element of the proposals, but where we differ, they are more about the means chosen rather than end aspirations. The point is about creating effective boards.

The proposals continue to demand and rely on independent directors to make effective boards a reality. Given that many issuers have only three INEDs around (to make up the one-third) to share the workload, the burden is high. A move towards majority INED can make INEDs collectively better able to play their director roles, and to enable issuer boards to have a larger group of INED talents to work with. It could and should enable the implementation of a number of the proposals in this consultation (plus requirements already existing) more effective and meaningful.

We ask stakeholders to join us in an on-going conversation as to how we can enhance the appreciation of the role and benefits of INEDs on an issuer's board. We will also have to pave the way for a supply of quality INEDs ready for board work at the top level to meet governance challenges.

Responses to consultation questions

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows:

Culture

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?

HKIoD Response:

- AGREE
 - Where purpose and value is the "what" and "why" of an issuer's existence, culture is the "how" of an issuer's way of actualising that purpose and value.

Culture is company specific. It must be for an issuer to recognise its own context and set a culture that is in alignment with its purpose, value and strategy and business model. Culture oversight intertwines with strategy, CEO/senior executive choices and risk management, and should be integrated pervasively into the board's work and agenda.

- Beware of sub-culture: Where an issuer has operations or centres of activities in multiple locations, or where the issuer is a conglomerate with various segments running on different business models, there is the tendency for local sub-culture to take over, a sub-culture that may deviate from the desired culture expressed at the top. If things go wrong, and with the speed with which news and rumour can travel through media channels, reputational impact can hit faster and a lot more frequent than imagined.
- INEDs have contribution to make: It is the board's role to set culture and monitor its practice throughout the organisation. Among the board directors, one would be right to pinpoint the role INEDs can and should have in culture. For most issuers on the Exchange, however, management dominates the board. The EDs by virtue of their jobs are involved in the operations of the company on a daily basis. If by metaphor we consider culture the oxygen of the organisation, the EDs will be breathing it every day. But they would inevitably be also breathing their exhaust, making them less able to smell trouble. INEDs have much to bring to the table. With outside perspectives they could spot things to which management insiders have their senses numbed. With numbers in the minority, INEDs would still find that harder to accomplish, however.

Anti-corruption and whistleblowing policies

Question 2 Do you agree with our proposal to:

- (a) introduce a CP requiring establishment of an anti-corruption policy; and
- (b) upgrade an RBP to CP requiring establishment of a whistleblowing policy?

HKIoD Response:

- As to (a), we AGREE with the introduction to a CP to require establishment of an anti-corruption policy
 - There is an evident connection between an effective anti-corruption policy and the culture that an issuer's board is to set and oversee.
 - Beware of sub-culture: Issuers especially those with operations and centres of activities in multiple locations should be sure that their respective anti-corruption policy adequately considers varying views and tolerance towards "grease payments" to facilitate business (versus bribes), but which comports with the shared foundational culture of the organization.
- As to (b), we AGREE with the upgrade to CP requiring establishment of a whistleblowing policy.
 - We expressed the view during the 2010/2011 CG Code review exercise that this should have been made a CP then, not just an RBP. We stand by our reasoning, that if we are to place value on whether an issuer has put in place arrangements for employees (or suppliers/customers) to raise concerns about

improprieties, we should also take the next logical step of preventing the issuer to take retaliatory actions against a whistleblower.

- It is equally important for an issuer's board to put in place policies and procedures to evaluate complaints and to judiciously decide which complaints truly warrant further actions. Complainants may insist on remaining anonymous. This could add to the difficulty in assessing the veracity of the complaints, but such should not mean anonymous complaints must be given light regard.

Enhancing board independence

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?

HKIoD Response:

➤ **AGREE**

- The proposal is not so much about directors' own independence, but on disclosure of a policy to ensure independent views and input are available to the board. For directors to bring independent judgment to bear on board decisions, there will be occasions for the board to want access to advisers not hired by the company, at company expense.
- Given that INEDs are mostly in the minority among issuers on the Exchange, the ability to request and select independent advisers at company expense is at the practical level more necessary for the INEDs than for the board generally.

Board refreshment and succession planning

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?

HKIoD Response:

➤ **As to (i), AGREE WITH RESERVATIONS**

- If the issuer can justify why the Long Serving INEDs should be re-elected, subjecting them to a specific independent shareholders' approval vote should not raise big issues. Long Serving INEDs being re-elected with an independent shareholders' vote would suggest an acceptance and endorsement by independent shareholders, but they would still be in the minority.
- Majority INEDs?: A better alternative may be to move towards a majority INED, to make INEDs collectively better able to perform their director roles and allow much more room for meaningful rotation and refreshment through careful succession planning.

➤ **As to (ii), AGREE**

- The Additional Disclosure is to justify why such INED is still considered independent and should be re-elected. This may call for an explanation of the factors considered, the process and the board/nomination committee discussion in arriving at the determination.

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?

HKIoD Response:

- As to appointing a new INED at the forthcoming annual general meeting where all the INEDs on the board are Long Serving INEDs, DISAGREE
 - If the issuer can justify why the Long Serving INEDs should be re-elected, they should not be made to add another INED just for compliance's sake. If the Long Serving INEDs are indeed stale and entrenched, to add one new INED to the mix would not solve the issue and the new appointee could in fact become the odd one out as to make the directorship ineffective.
 - Majority INEDs?: A better alternative may be to move towards a majority INED, to make INEDs collectively better able to perform their director roles and allow much more room for meaningful rotation and refreshment. We believe this can enable issuers to work a succession planning off a larger group of INEDs with the right mix of longer serving members with knowledge and familiarity with the business and those with lesser tenure but fresh perspectives.
- As to disclosing the length of tenure of Long Serving INEDs on a named basis in the shareholders' circular, AGREE
 - This would be to present facts which provides shareholders with information.

Equity-based remuneration to INED

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?

HKIoD Response:

- DISAGREE
 - We do not see the need to introduce the RBP.
 - If a straight-jacket directors' fee remuneration is meant to ensure "neutrality" and to keep directors from being mired with personal gains in their decision making, there is then the equally likely opposite effect, that because the flat retainer is all that is there, the director need not be rigorous and need not earn the money the hard way. Directors' fees for INEDs among Hong Kong issuers are not high; some say meagre. They do not really reflect the increasing burden and liabilities that are thrust on the INEDs.
 - Equity-based remuneration can align incentives of directors with shareholders, all shareholders. Equity-based remuneration, if it rewards actual share value appreciation and risks assumed, can make for a needed incentive for the INEDs to perform and prove their worth in value creation. When EDs on the same board can be rewarded with equity-based remuneration, we do not see

why INEDs should be deprived of their opportunity to participate in the economic success of the company. Under current rules on share option schemes, maximum entitlement to share option scheme participants are kept at a low 1% threshold anyway.

- The nature and the detail of the equity-based remuneration is key. The right design will factor the issuer's needs and the qualities of the recipient INEDs into the analysis. Appropriate vesting schedules to go along with well-reasoned expected payout can align compensation for good service while protecting the issuer. We need not go too far in cautioning against all forms of equity-based remuneration.

Diversity

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?

HKIoD Response:

- We do not have a consensus at this moment.

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)?

HKIoD Response:

- We do not have a consensus at this moment.

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?

HKIoD Response:

- AGREE
 - We believe issuers should have a well thought out policy to achieve diversity. Issuers should review periodically to ensure effective implementation.

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

HKIoD Response:

- AGREE
 - We do believe the inclusion of gender information is to present facts which provide shareholders with information.

Nomination committee

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?

HKIoD Response:

- As to the proposal to upgrade a CP to a Rule requiring issuers to establish a Nomination Committee chaired by an INED and comprising a majority of INEDs, **AGREE WITH RESERVATIONS**
 - As we commented during the 2010/2011 CG Code review exercise, there was (and is still) a strong argument for making this a Rule but we felt a CP should already give sufficient impetus for issuers to establish such committee. As the Consultation Paper has noted, 95% of the sample issuers has complied. For the others that do not have a specific Nomination Committee, if the function is otherwise properly performed (for instance, being handled by another committee properly constituted, or being treated at the full board level) such is not a per se detriment to corporate governance. There is a rational argument for letting things be.
 - We garner that scrutiny by independent directors is an important part of the proposal. For many issuers, there are only the three around (that makes up the one-third) to do the work.

Communication with shareholders

Question 8 Do you agree with our proposal to upgrade a CP to a MDR to require disclosure of the issuer's shareholder 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 view of shareholders and stakeholders) and annual review of such policy to ensure its effectiveness?

HKIoD Response:

- **AGREE**
 - High-quality communication with shareholders and stakeholders is a key ingredient to corporate governance and an important aspect of a board's work. Board-shareholder/stakeholder communications benefit both sides.
 - Majority INED?: The Consultation Paper alluded to some discussions on the pros and cons for having a Lead or Senior INED to facilitate board-shareholder/stakeholder communication. Para 101. HKIoD contributed to that discussion and raised our concerns. Those concerns aside, we also conveyed the notion that a Lead INED concept would be more meaningful and practical, whether for shareholder/stakeholder communication or for more general board leadership, if there is a majority of INEDs of the board.

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

HKIoD Response:

➤ AGREE

- The current proposal is to introduce a Rule to require more timely disclosure of the fact of directors' attendance (or not) at general meetings, right with the poll results announcements. The current requirement is merely to publish in the CG Report in the year end, which would be a long lag and indeed could be too long. See Consultation Paper para 104. To publish the information with poll results announcements should not be too onerous on issuers.

Disclosure on Audit Committee's work

There are no specific consultation questions in this segment. The proposal calls for better disclosure of the Audit Committee's work. Consultation Paper para 106-109. We have no specific comments at this time.

Deletion of NEDs for specific terms CP

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

HKIoD Response:

➤ AGREE

- It is sufficient that a director is subject to some re-election (or rotation) requirement. A rotation at least once every three years is a reasonable length, giving the director sufficient time to learn the business to enhance his/her contribution, but frequent enough scrutiny to test the value of contribution (and, in some cases, see if the tenure has become too long to render the director not having fresh perspectives to contribute to the board discussion and may be even straddle into territory that casts doubt as to independence). An annual re-election could be too frequent an interval as to render the process perfunctory, but this would be for the issuer to decide according to their own circumstances.

Elaborate the linkage between CG and ESG

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?

HKIoD Response:

➤ As to (a), AGREE

- Issuers should consider ESG factors in the context of their business model and strategy for value creation, and to do so by tying them to operational and financial performance. Monitoring performance and devising strategy are the two fundamental realms of what we see and practise as corporate governance.

➤ As to (b), AGREE

- An issuer's business model and strategy must be devised with reference to risks that could come with the prospective opportunities to be had. To nail down to a strategy requires a risk assessment; ESG factors factor into that risk assessment because the viability of the business model/strategy will depend on

one or more ESG factors. It is for the issuers to identify the ESG factors that are material to them.

Timely disclosure of ESG reports

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?

HKIoD Response:

➤ **AGREE WITH RESERVATIONS**

- Issuers should consider ESG factors in the context of their business model and strategy for value creation, and to do so by tying them to operational and financial performance. This would be a strong reason to support requiring publication of ESG reports at the same time as that of annual reports.
- A contrarian view would be to let issuers decide the temporal periods or cycles in which they report on ESG matters.
 - Conceivably, some issuers may find it more convenient (and more helpful to investors/readers) to report on ESG matters (or some aspects of such) on a time cycle different than annual financial reporting. A plantation business may have adopted an annual reporting cycle based on corporate administrative and legal considerations, but some of its ESG factors (e.g., climate/weather and its effect on the growth cycle) may be more meaningful if explained on a cycle closer to what nature would give.
- On balance, we can support the proposal, but would recommend flexibility still by permitting issuers to opt for a different ESG reporting cycle. There should then be sufficient disclosure to “reconcile” the substance of the ESG reporting with the narrative in the annual report.
 - The “extra work” may already drive issuers to move to simultaneous publication, but in some cases the “extra work” could produce more useful information to investors/readers. Let issuers decide.

CG Code structure

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 untended consequences?

HKIoD Response:

- We have no specific comments at this time.

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?

HKIoD Response:

- We have no specific comments at this time.

Implementation dates

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

HKIoD Response:

- As to (a), AGREE
- As to (b), see our response to Question 4(a) and 4(b).

ENDS