New measures for higher level of corporate governance

August 2018

In brief

On 27 July 2018, the Stock Exchange of Hong Kong Limited (the “Exchange”) published the conclusion (the “Conclusion”) of its consultation on its Corporate Governance Code (the “CG Code”). The CG Code introduces new measures to:

- strengthen the accountability of the board and the nomination committee
- improve transparency of independent non-executive directors’ (‘INEDs’) relationships with issuers
- enhance the independence criteria for assessing potential INED candidates
- promote board diversity, and
- enhance transparency of dividend policy.

The Exchange also published the “Guidance for Boards and Directors” (the “Guidance”) to help directors carry out their roles more effectively. It summarises the existing Listing Rules and CG Code, as well as the proposed new amendments under the Conclusion, to cover directors’ duties and board effectiveness, board committees, board diversity and corporate governance for weighted voting rights issuers.

The amended Rules and CG Code contained in the Conclusion will take effect on 1 January 2019.

In detail

In relation to the Exchange’s consultation on 3 November 2017, it published the Conclusion on 27 July 2018. Most of the proposals outlined in the consultation will be adopted, with certain modifications or clarifications.

We summarised the major changes to the CG Codes below.

Independent non-executive Directors

INEDs play an increasingly important role in assuring investor confidence. They are expected to exercise independent judgement, and oversee and guard against any conflicts of interests. The following amendments under the Conclusion will impose greater demand on the board and the nomination committee.

Overboarding

To ensure the INED candidate can make sufficient time available to discharge their responsibilities, the Exchange will amend code provision A.5.5 of the CG Code. If the INED candidate will be holding his/her seventh (or more) listed company directorship, the issuer will need to set out in the relevant circular to shareholders why the board believes the candidate would still be able to devote sufficient time to the board.
The nomination committee or the board should look at a INED candidate’s time commitments in relation to listed companies, as well as his/her other significant time commitments. A personal confirmation from the INED candidate on time commitment may be helpful, but not required by the Exchange. Ultimately, it should be the board or the nomination committee who is responsible for conducting the due diligence prior to the nomination and be accountable to shareholders.

The Guidance sets out factors that the board or the nomination committee should be aware of when assessing the INED candidate’s time commitment to the issuer:

- directorship at another listed issuer undergoing a period of particularly increased activity;
- chairing another listed issuer’s board and/or board committees;
- members of board committees;
- a CEO or full time executive director at another listed issuer; and
- an INED for multiple boards and a number of significant commitments at government or non-profit making bodies

Election of INED

The Exchange will amend code provision A.5.5 requiring the board to state the following in the relevant circular to accompany the resolution to elect the INED:

- the process used for identifying the individual and why the board believes the individual should be elected and the reasons why it considers the individual to be independent; and
- the perspective, skills, experiences that the individual can bring to the board.

Independence of INED

Rule 3.13 sets out a non-exhaustive list of factors that the Exchange takes into account when assessing the independence of INEDs. Among which, the INED’s independence is likely to be questioned if:

- under Rule 3.13(3), the proposed INED is a director, partner, principal or an employee of a professional adviser which currently provides or has within one year immediately prior to the date of his/her proposed appointment provided services to the issuer and related entities.
- under Rule 3.13(4), the proposed INED has current material interests in any issuer’s principal business activities of and is involved in any material business dealings with the issuer.

The Exchange will amend:

- Rule 3.13(3) and extends the cooling off period for professional advisers from one year to two years. Similarly, for the sake of consistency, the Exchange also amends code provide C.3.2 of the CG Code to extend the cooling off period from one year to two years for former partners of the issuer’s audit firm to act as a member of the issuer’s audit committee; and
- Rule 3.13(4) to introduce a one year cooling off period for a proposed INED who has had material interests in the principal business activities of or business dealings with the issuer in the past year.

The Exchange will also introduce a note under Rule 3.13 such that the same factors under Rule 3.13 should also apply to the INED’s immediately family members. “Immediately family members”, which has the same meaning as Rule 14A.12 (1)(a), is defined as “his spouse, his (or his spouse’s) child or step-child, natural or adopted, under the age of 18 years”.

Furthermore, the Exchange will also introduce a new recommended best practice A.3.3 under the CG Code to recommend disclosure in the corporate governance report explaining why a proposed INED is considered independent notwithstanding that the individual holds cross-directorships (e.g. when two or more directors sit on each other’s boards) or has significant links with other directors through involvements in other companies or bodies.
Chairman’s annual meetings with INEDs

The Exchange will amend code provision A.2.7 of CG Code such that the chairman should hold meetings with the INEDs at least annually without the presence of other directors.

Board diversity

Directors comprises of different competencies and diversity of perspectives is good for corporate governance as it promotes board effectiveness. Diversity encompasses more than simply gender, but also cultural, educational background and professional experiences etc.

Diversity policy

Currently code provision A.5.6 of the CG Code states that the nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose the policy or a summary of the policy in the Corporate Governance Report.

The Exchange will upgrade the abovementioned code provision to new Rule 13.92 to require the nomination committee (or the board) to have a policy concerning diversity of board members and disclose the policy, or a summary of the policy, on diversity in the corporate governance report.

The board should also set out in the relevant circular how such proposed director contributes to the diversity of the board (amended code provision A.5.5). The Guidance also emphasises that the board’s consideration and rationale in this area should be explained clearly in the relevant circular.

The Guidance suggests that a diversity policy should include measurable objectives and progress in achieving those objectives. It also sets out directions for issuers when they formulate their diversity policies:

- articulate the benefits of diversity, including gender diversity, and the importance of being able to attract, retain and motivate employees from the widest possible pool of available talent;
- express the issuer’s commitment to diversity at all levels, including gender, age, cultural and educational background, or professional experiences;
- assess annually on each issuer’s diversity profile including gender balance of the directors and senior management and their direct reports, and its progress in achieving its diversity objectives;
- ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered; and
- state whether the issuer has identified and implemented programs that will assist in the development of a broader and more diverse pool of skilled and experienced employees and that, in time, their skills will prepare them for senior management and board positions.

The Guidance also recommends issuers to compile and disclose a board skills matrix that displays the board members’ proficiency in specified skills, experiences and diversity of perspectives. It helps the board to assess the current mix of competencies and diversity on the board and the investors to understand the process for board’s selection and appointment of directors.

Nomination policy

The Exchange will amend the Mandatory Disclosure Requirements L.(d)(ii) to require an issuer to disclose its nomination policy adopted during the year. This includes the nomination procedures and the process and criteria adopted by the nomination committee to select, appoint and reappoint directors. The Guidance further clarifies that the selection criteria should include considering the potential contributions a candidate can bring to the board in terms of qualifications, skills, experiences, independence and gender diversity.
**Dividend policy**

The Exchange will introduce a new code provision E.1.5 in the CG Code requiring the issuers to have a policy on payment of dividends and should disclose it in their annual reports.

For further details on the Conclusion and Guidance, please refer to the links below:

- The Conclusion
- The Guidance

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**Let’s talk**

For any enquiries on our services, please directly contact your PwC engagement team or below contact.

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