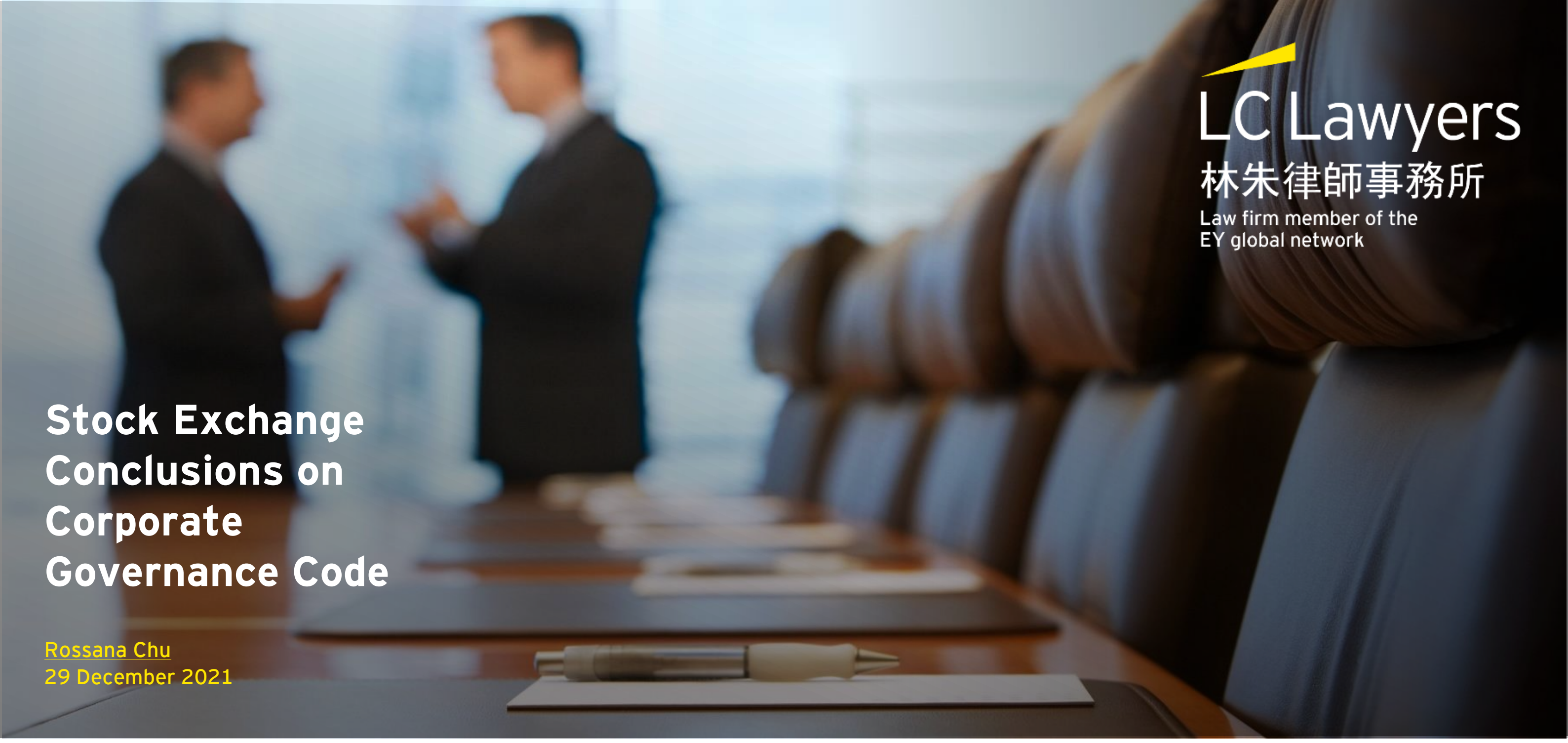

Stock Exchange Conclusions on Corporate Governance Code

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The Stock Exchange of Hong Kong Limited ("Stock Exchange") published in December 2021 the conclusions[1] to its consultation paper of April 2021 titled "Review of Corporate Governance Code and Related Listing Rules"[2], with an aim to enhance the corporate governance practices and reporting by listed companies.

The Stock Exchange adopts most of the proposals outlined in the consultation paper, with certain modifications or clarifications, in the respect of (i) culture, (ii) board independence and refreshment, (iii) diversity, (iv) nomination committee, (v) communications with shareholders, (vi) certain enhancements relating to directors, (vii) linkage between corporate governance and ESG (environment, social and governance), (viii) timely disclosure of ESG reports and (ix) re-arrangement of the Corporate Governance Code.

In this article, we will focus on three controversial areas as the Stock Exchange received highest rates of opposing responses (up to 36%) in its Consultation Conclusion[1]. These areas are board independence, refreshment and gender diversity.

Board independence

Independent non-executive directors ("**INEDs**") in Hong Kong listed companies are expected to play a crucial role in achieving good corporate governance. They should be able to provide independent oversight and constructive challenge to the executive directors, but a core condition is that they do not have a material or pecuniary relationship with the listed company or its related persons.

[1] https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/April-2021-Review-of-CG-Code-and-LR/Conclusions-(Dec-2021)/cp202104cc.pdf?la=en

[2] https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/April-2021-Review-of-CG-Code-and-LR/Consultation-Paper/cp202104.pdf

The Listing Rules for the Main Board and GEM in Hong Kong set out a non-exhaustive list of factors to be taken into account when assessing "independence" of INEDs. Currently, there is a requirement to disclose each INED's cross-directorships or significant links with other directors in the Corporate Governance Report, and the board is also required to set out the reasons why it considers the individual to be independent.

Proposal: In furtherance of this, the Stock Exchange proposed to require disclosure of a policy to ensure independent views are available to the board and an annual review of the implementation and effectiveness of such policy. 70% of the respondents supported the proposal and 30% opposed it. Some respondents considered that the proposed policy cannot address independence issues because of the difficulty to measure "independent views".

Conclusion: This proposal is adopted with certain revised wordings, and will apply to financial year commencing on or after 1 January 2022. The Stock Exchange pointed out that the aim is to urge listed companies put in place mechanisms to ensure a strong independent element on the board which is key to an effective board. Those mechanisms do not necessarily have to be set out on a standalone basis, but may be covered in the INED recruitment process (e.g. in respect of time commitments/ qualifications), the number of INEDs, the assessment or evaluation of INEDs' contribution, or other channels where independent views are available (e.g. by directors' access to external independent professional advice to assist in the performance of their duties).

Also, the Stock Exchange published a "Corporate Governance Guide for Boards and Directors" [3] in December 2021 which includes suggestions on how to conduct board evaluation, e.g. the steps involved and how to disclose the results of the evaluation for accountability and transparency.

Board refreshment

For a long-serving INED who has served more than 9 years, the listed company is currently required to make a separate shareholders' resolution for further appointment of a long-serving INED and explain to shareholders why the board believes such INED is still independent and should be re-elected, otherwise the company has to explain why such a shareholders' resolution is not necessary.

As of 31 December 2020, around 17.7% of INED directorships were occupied by long-serving INEDs who sit across almost 1/3 of listed companies. Around 150 listed companies (5.9%) had all their INEDs serving the boards for 9 years or more.

The consultation paper pointed out that serving as INED on a board for a prolonged period may increase the risk of complacencies given the familiarity with management. Similar concerns are also shared by regulators in the UK, Singapore and Australia. More importantly, regular reviews and refreshment of INED directorship

[3] https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Corporate-Governance-Practices/guide_board_dir.pdf?la=en

may enhance accountability of the board and generate new ideas and business strategies.

Proposals: The Stock Exchange proposed that (a) the re-election of a long serving INED be subject to approval by independent shareholders and (b) additional disclosure on such INED's independence and suitability to re-elected. This proposal met with opposition from 35% of the respondents. The divergence of views was around independent shareholders' approval and opposing respondents commented that all shareholders should be entitled to vote on board appointments. The proposed additional disclosure received wide acceptance.

Another proposal is the appointment of a new INED where all INEDs are long serving. 71% of the respondents supported and 29% opposed it.

Conclusions: Considering the different views, the Stock Exchange decided that:

- Independent shareholders' approval of the re-election of a long serving INED is not required.

- Additional disclosure should be made on factors considered, the process and the discussion of the board of the nomination committee on why the long-serving INED is still independent and should be re-elected. Such requirement will apply to the financial year commencing on or after 1 January 2022.

- A listed company must appoint a new INED if all its existing INEDs are long-serving. The Stock Exchange appreciates concerns regarding the difficulty in finding suitable INED candidates and will allow a transition period by implementing this requirement to the financial year commencing on or after 1 January 2023.

- The length of tenure of the long-serving INEDs must be disclosed on a named basis in the shareholders' circular, and such requirement take effect for the financial year commencing on or after 1 January 2022.

Gender diversity of board members

The board of a listed company should have a balance of skills, experience and diversity of perspectives appropriate for the company's business.

Currently, a listed company must have a board diversity policy and disclose the policy (or a summary) in its Corporate Governance Report, which should include any measurable objectives that it has set for implementing the policy, as well as the progress on achieving those objectives. Starting from May 2019, the Stock Exchange requires an IPO applicant to disclose its board diversity policy in its prospectus, and any applicant with a single gender board is further required to make additional disclosures on how gender diversity can be achieved.

Despite such requirements, only 12.7% of Hong Kong listed companies' directorships were held by woman in 2020, while women held 34.4% of directorships in the UK, 28.2% in the US, and 19.5% in Singapore. More recent statistics as of 31 December 2020 show that 32.1% of the 2,538 Hong Kong listed companies had no female directors while around 37.4% had only one.

Proposals: In order to further promote gender diversity which is more easily measured as compared to other diversity aspects, the Stock Exchange proposed that:

- Single gender board not to be acceptable. 24% of the respondents opposed it. Some supporting respondents even suggested a minimum women director proportion to be achieved within specific timeline, while the opponents argued that director appointments should be under a fair system based on merit and the proposal might lead to tokenism.

- Each listed company to set and disclose numerical targets and timelines for achieving gender diversity at board level and across the workforce (including senior management). This met with opposition from 36% of the respondents. In respect of targets at workforce level, respondents questioned the feasibility and meaningfulness of setting targets, as some industries are constrained by the industry nature, or the country where the main operation is located.

- Annual review to be carried out on the implementation and effective of the board diversity policy. 88% of the respondents supported the proposal and 12% opposed it.

- The forms to be filled in by new directors be amended to include directors' gender information, and the director's age, gender and other directorships be displayed on the Stock Exchange website. Again, this proposal was widely supported by 87% of the respondents.

Conclusions: The Stock Exchange decided that:

- Single gender board will be phased out, i.e. the Stock Exchange will not consider diversity to be achieved for a single gender board. To strike a balance against the practical situations for Hong Kong listed companies, the Stock Exchange allows existing listed companies with single gender boards to have a three-year transition period (i.e. no later than 31 December 2024) to appoint at least a director of a different gender. Also, for any listing application filed on or after 1 July 2022, the IPO applicant with single gender board will not be accepted.

- The numerical targets and timelines for achieving gender diversity are required only at board level. For the workforce level, a listed company must disclose (i) gender ratios in the workforce (including senior management), (ii) any plans or measurable objectives set for achieving gender diversity and (iii) any mitigating factors or circumstances which make achieving gender diversity across the workforce (including senior management) more challenging or less relevant.

- Annual review of board diversity policy will be required, with information on a board skills matrix included in the Stock Exchange's Corporate Governance Guidance.

- The director's forms will be amended to include directors' gender information.

- The second to fourth proposals will be implemented to the financial year commencing on or after 1 January 2022.

Takeaways

The Stock Exchange has stressed the importance of enhancing corporate governance. Apart from starting to prepare for the new requirements, listed companies need to appreciate that such requirements are neither the highest standards nor the ultimate targets. The public will increasingly raise expectations for corporate governance.

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