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Hong Kong Stock Exchange Consults on Review of Corporate Governance Code and Related Listing Rules

On 3 November 2017, the Stock Exchange of Hong Kong (the **Exchange**) published its [Consultation Paper on Review of the Corporate Governance Code and Related Listing Rules](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Consultation-Paper/cp2017111.pdf) (the **Consultation Paper**) which addresses:

* overboarding and time commitment of Independent non-executive directors (**INEDs**);
* board diversity;
* INEDs’ independence; and
* the responsibilities of Nomination Committees.

The Exchange also notes that it will provide guidance in due course encouraging the appointment of INEDs at least two months prior to listing.  The consultation period will end on 8 December 2017.

**INEDs’ overboarding and time commitment**

Code Provision (**CP**) A.1 requires the boards of listed companies to regularly assess the contributions required of directors to perform their responsibilities to the company, and whether each director devotes sufficient time to their duties.

CP A.6.3 requires directors to ensure that they are able to devote due time and attention to the position and to not accept the appointment if they cannot. They are also obliged to disclose to the listed company at the time of their appointment the number and nature of offices held in public companies or organisations, the identities of which should be disclosed, and other significant commitments, with an indication of the time involved. Any change should be disclosed in a timely manner.[[1]](#_ftn1)

Currently, CP A.5.5 requires the board to send out a circular and/or an explanatory statement to shareholders explaining the reasons for the candidate’s election and their reasons as to why the person is considered to be independent.

The Exchange proposes to add to CP A.5.5 a requirement to explain why the INED would be capable of devoting sufficient time to the board if he or she is holding a seventh (or more) listed company directorship, given existing market concerns regarding such candidate INEDs. The Exchange highlights that the proposal does not limit the number of directorships permitted to be held, but rather enhances transparency on the nomination committee/the board’s considerations with respect to election of such INEDs.

The Exchange additionally proposes to provide guidance on considerations relevant to assessing INED nominees’ overboarding.

**Board diversity**

The Exchange proposes to add to CP A.5.5 (with subsequent amendments to Mandatory Disclosure Requirement L.(d)(ii)[[2]](#_ftn2)) a requirement to include in the circular to shareholders the process that has been followed in identifying the nominee, the perspectives, skills and experience the person is expected to contribute to the board, and the nominee’s contribution to diversity of the board.

Currently, CP A.5.6 requires the nomination committee/the board to have a policy on board members’ diversity, and to disclose the policy or a summary of the policy in the Corporate Governance Report. The corresponding Note provides that diversity can be achieved through consideration of factors such as gender, age, cultural and educational background, professional experience and others.

The Consultation Paper proposes to upgrade CP A.5.6 to a Listing Rule, thus making this a mandatory requirement rather than a practice subject to “comply or explain”.  The Exchange notes that Hong Kong lags behind its international counterparts with respect to board diversity, particularly with regard to the representation of women on boards.

**Independence of INEDs**

The Exchange proposes to prolong the cooling-off period for a nominated INED who is a former director, partner, principal or an employee of a professional adviser from one year[[3]](#_ftn3) to three years. The revision is proposed since the current cooling off period is shorter than that of Hong Kong’s international counterparts. It is also proposed to prolong the cooling off period for former partners of the listed company’s audit firm to act as a member of the company’s audit committee from one year to three years by amending CP C.3.2.

The Exchange is further consulting the market on whether all of the independence criteria for INEDs should be included in the Listing Rules rather than being CPs.

Currently, Rule 3.13(4) only applies where a proposed director has a current material interest in the listed company’s principal activities, but does not take into account material interests held in the previous year. To align Hong Kong’s regulation with the international practice, the Exchange proposes to amend Rule 3.13(4) to include a one-year cooling off period for a proposed INED who has had material interests in the listed company’s principal business activities in the past year.

The Exchange is proposing to recommend disclosure in the Corporate Governance Report of an INED’s cross-directorships, or that the INED has significant links with other directors through involvements in other companies or bodies, since there are no requirements to account for such connections currently.

A Note under the independence criteria Rule 3.13 is proposed which will encourage inclusion of an INED’s immediate family members’ connection with the listed company in the assessment of their independence, with the definition for “immediate family member” being the same as that in Listing Rule 14A.12(1)(a). The rationale for the change is that a director’s independence may be affected by the ties of the director’s immediate family members.

**Nomination Committee’s responsibility**

Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 currently requires the nomination committee to disclose a summary of its work over the year, including its determination of the nomination policy and the nomination process and the criteria used for the selection of candidates for director roles.

The Exchange proposes to amend the Disclosure Requirement to require issuers to disclose their nomination policy adopted during the year. Such disclosure should demonstrate the board’s regard for Code Principle A.3 which states that the board should have a balance of skills, experience and diversity of perspectives appropriate to the requirements of the listed company’s business.

**Directors’ attendance at meetings**

CP A.6.7 requires, among other things, that INEDs and NEDs attend general meetings and develop a balanced understanding of shareholders’ views. The Consultation Paper proposes to remove this requirement, since this provision could be read as contradicting the Exchange’s view that a directors’ absence from a general meeting does not constitute a breach of the CP.

The chairman is currently required to hold meetings with the NEDs (including INEDs) at least annually without the executive directors present, pursuant to CP A.2.7. The Exchange proposes to revise this provision to require INEDs to meet at least annually with the chairman even if the chairman is not an INED. This proposal stems from the Exchange’s observation that in around 36% of listed companies, the roles of chairman and chief executive are performed by the same person.

**Dividend policy**

There are no disclosure requirements on dividend policy for listed companies at present. The Exchange proposes to introduce new CP E.1.5 which will require companies to disclose their dividend policy in their annual reports in line with comparative requirements in the UK and US.

**Electronic dissemination of corporate communications – implied consent**

Electronic dissemination of corporate communications by listed companies is permitted by Rule 2.07A(2A), provided that shareholders grant express or deemed consent, with requests for consent and election of language for the corporate communications made by hard copies. Listed companies should notify shareholders using hard copies whenever new corporate communications are published on the website.

The Exchange seeks market opinion on whether shareholders’ consent should be permitted for electronic dissemination of corporate communications by listed companies. This Listing Rule amendment will be only implemented if further amendments to Hong Kong’s company law are made to permit this.

[[1]](#_ftnref1) Pursuant to CP A.6.6

[[2]](#_ftnref2) Currently requires an issuer to include its diversity policy or a summary of it in its Corporate Governance Report, as well as any “measurable objectives that it has set for implementing the policy, and progress on achieving those objectives”.

[[3]](#_ftnref3) Currently required by Rule 3.13(3).

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