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[online version](http://www.charltonslaw.com/hkex-publishes-consultation-paper-on-review-of-the-code-on-corporate-governance-practices-and-associated-listing-rules/)

# HKEx Publishes Consultation Paper On Review Of The Code On Corporate Governance Practices And Associated Listing Rules

## Introduction

Hong Kong Exchanges and Clearing Limited ("**HKEx**") published a consultation paper on 17 December 2010 regarding proposed changes to the Code on Corporate Governance Practices ("**the Code**"), the Corporate Governance Report and certain Listing Rules regarding corporate governance. The proposals represent an attempt on the part of HKEx to ensure the highest standards of corporate governance and bring Hong Kong into line with international best practice in this area, with the principal aim of the new framework being the encouragement of increased accountability on the part of issuers and directors. The proposals involve the revision of some Listing Rules which are unnecessarily burdensome on the market, the upgrading of some Code Provisions ("**CPs**") to Listing Rules and the upgrading of some Recommended Best Practices ("**RBPs**") to CPs. As before, issuers have the flexibility to decide whether or not to comply with the CPs. If issuers decide not to adopt a CP, they must explain the reasons for the decision in their corporate governance report. For RBPs, issuers are encouraged, but not required, to state whether they have adopted them. Compliance with the Listing Rules is mandatory. HKEx note that although reference is made throughout the Consultation Paper to the Main Board Listing Rules, the proposals are intended to apply also to the GEM Listing Rules and equivalent changes will be made. HKEx's Consultation Paper makes regular reference to the regimes in other jurisdictions, such as the UK, Australia and the Mainland, and takes their positions into account in formulating proposals.

Key features of the extensive new proposals include:

* An effort to improve transparency by bolstering requirements for disclosure and communication with stakeholders;
* A drive to enhance the quality of directors and company secretaries by requiring them to undergo training;
* A requirement for independent non-executive directors ("**INEDs**") to become more involved in issuers' board committees;
* A recognition of company secretaries' contribution to corporate governance and an effort to define their role and function; and
* The placing of greater emphasis on the leadership role of the chairman of the board in corporate governance matters.

Some of the principal changes are:

* The RBP that INEDs should comprise one third of the board will be upgraded to a Listing Rule (full compliance to be required by December 2012);
* The requirement for the establishment of a Remuneration Committee with a majority of INEDs as members and chaired by an INED will be Listing Rule rather than a CP;
* The Nomination Committee requirement will be a CP rather than a RBP;
* A new RBP will require issuers to either set up a dedicated Corporate Governance Committee or expand the role of an existing board committee to cover corporate governance matters;
* A new CP requiring issuers to avoid the "bundling" of shareholders' resolutions which are not interlinked;
* A new Listing Rule requirement for shareholders' approval at general meeting for any proposal to appoint an auditor or remove an auditor before the end of his term of office;
* A new Listing Rule requiring disclosure of an issuer's constitutional documents on the issuer's and HKEx website; and
* A new rule on the acceptable qualifications for Company Secretaries and removal of the requirement for ordinary residence in Hong Kong.

HKEx have also taken the opportunity to re-draft, in plainer language, the Code and Rules affected by the policy proposals. HKEx invite written responses from market participants to the proposals advanced in the Consultation Paper and these must be submitted by 18 March 2011, after which a Consultation Conclusions Paper will be published. The Consultation Paper and list of questions for market participants can be viewed at [*here*](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010124.pdf).

## The Proposed Amendments: Directors

### Directors' Duties and Time Commitments

#### The Current Regulatory Framework

HKEx note in the Consultation Paper that they expect directors to fulfil their fiduciary duties and duties of skill, care and diligence to a standard at least equal to those of Hong Kong law. Under the Rules, every director must act honestly and in good faith in the interests of the company as a whole, act for proper purpose, be answerable to the issuer for the application or misapplication of its assets and avoid conflicts of interest, while disclosing fully his interests in contracts with the issuer. Rule 3.08 states that an issuer's board is collectively responsible for its management and operations.

CP A.5.3 states that every director should ensure that he can give sufficient time and attention to the issuer's affairs. RBP D.1.4 states that issuers should have formal letters of appointment for directors setting out the key terms and conditions of their appointments. RBP A.5.6 encourages a director to disclose to the issuer, at the time of his appointment, the number and nature of offices held in public companies or organisations and other significant commitments. The board can decide how often a director should make this disclosure. However, HKEx highlight the fact that there is no Code recommendation for a review of directors' time commitments.

#### HKEx Proposals

HKEx discuss a number of issues arising from the issues of how to ensure that directors are giving sufficient time to the companies on whose boards they sit and how to ensure that they fully understand the scope of their duties. A key concern involves the number of directorships which certain Independent Non Executive Directors ("**INEDs**") take on, as this limits their ability to concentrate fully on their responsibilities to any one company. However HKEx reject the suggestion of limiting the amount of directorships any individual may hold at a given time, on the basis that this would unjustly punish those diligent INEDs who successfully serve a number of issuers.

In order to ensure that directors comprehend fully the nature of their duties HKEx propose:

* expanding Rule 3.08 to state that directors must take an active interest in the issuer's affairs, obtain a general understanding of its business and follow up anything untoward that comes to their attention; and
* providing guidance to directors in a Note to the Rule. This Note will refer directors to the Companies Registry's "A Guide on Directors' Duties" and Hong Kong Institute of Directors' ("**HKIOD**") "Guidelines for Directors" and the "Guide for Independent Non-executive Directors", the first of which sets out the principles of director's duties while the latter two give instructions on how to apply those principles in practice.

In order to address market concerns regarding the time commitments of directors, HKEx propose the following measures:

* The addition of two new paragraphs to the duties contained in the nomination committee's terms of reference under RBP A.4.5 (upgraded and re-numbered CP A.5.2). These proposed new duties (CPs A.5.2(e) and (f)) recommend that the nomination committee (a) regularly review the time required from a director to perform his responsibilities to the issuer and whether he has committed that time and (b) review the non-executive directors' annual confirmations that they have spent sufficient time on the issuer’s business made under CP A.5.3 (re-numbered CPA.6.3)
* The amending of Appendix 23 (re-numbered paragraph L(d)(ii) of Appendix 14) to require the nomination committee to disclose in the issuer's corporate governance report that it has received and reviewed the non-executive directors' annual confirmation made under re-numbered CP A.6.3.
* The expansion of CP A.5.3 (re-numbered CP A.6.3), recommending that a director should limit his other professional commitments and certify to the issuer that he will have sufficient time to meet his obligations. In addition, a non executive director ("**NED**") should confirm annually to the nomination committee that he has spent sufficient time on the issuer's business.
* The upgrading of RBP D.1.4 to a CP, with revised wording stating that letters of appointment for non-executive directors should set out the time commitment expected of them.
* The upgrading of RBP A.5.6 to a CP (re-numbered CP A.6.6) and its amendment to encourage directors to inform the issuer's board of any change to their significant commitments. HKEx are seeking market input on whether a limit should be imposed on the number of INED positions an individual may hold and, if so, what it should be and whether the recommendation should take the form of a CP or RBP.

### Directors' Training and INEDs

#### Current Regulatory Framework

At present the training of directors and INEDs is regulated largely through RBPs:

* RBP A.5.5 states that all directors should participate in continuous professional development arranged and funded by the issuer.
* RBP A.3.2 recommends that at least one-third of an issuer's board should be INEDs.
* RBP A.4.3 states that serving on an issuer’s board for more than nine years could be relevant to the independence of an INED. Any further appointment of the INED should be subject to a separate resolution to be approved by shareholders.
* RBP A.4.8 encourages the board to include in a circular nominating a person for election as an INED an explanation as to why the person should be elected and why the issuer considers him independent.

In addition to the above, Rule 3.13 states that an INED must inform the Exchange as soon as practicable of any change of circumstances that may affect his independence and provide an issuer with an annual confirmation of that independence. The issuer must disclose in its annual report whether it has received this confirmation and state whether it still considers the INED to be independent.

#### HEKx Proposals

In the Consultation Paper, HKEx highlight the importance for directors of keeping up to date with developments in the Code, the Listing Rules, accounting standards and company law. Failure to do so is often a key reason why directors are found to be in breach of their duties. The vital part that INEDs play is also focused on by HKEx, particularly their role as the representatives of the shareholder body and their key functions as part of the remuneration, nomination and audit committees.

In light of the above considerations HKEx propose the following:

Directors' training

* To upgrade the recommendation for directors' continuous professional development (RBP A.5.5) to a CP (re-numbered CP A.6.5). It is also proposed to amend the new CP to state that: (a) the training should place "an appropriate emphasis on the roles, functions and duties of an Exchange listed company director"; and (b) directors should receive a minimum of eight hours of training in each financial year. If the proposal is adopted, guidance will be published on how this eight hour target is to be met. Finally HKEx propose that the issuer's company secretary should keep a record of each director's training for each financial year.

INEDs to form one-third of board and transitional period

* Under the new regulatory framework the recommendation that INEDs comprise at least one-third of the board from RBP A.3.2 will be upgraded to a Rule (re-numbered Rule 3.10A). In order to allow issuers to ensure their compliance with this development a transitional period will be permitted, with full compliance required by 31 December 2012.

An INED who has served nine years

* HKEx aim to upgrade the recommendation that shareholders vote on a separate resolution to retain a director who has served on a board for more than nine years from RBP A.4.3 to a CP (re-numbered CP A.4.3).

Circular nominating INED for election

* A further upgrade is to be made to RBP A.4.8, transforming it into a CP (re-numbered CP A.5.5). The current RBP A.4.8 recommends the board include an explanation as to why the person should be elected and why the issuer considers him independent, in a circular nominating a person for election as an INED.

## Board committees

### Remuneration Committee

#### Current Regulatory Framework

Code Principle B.1 regulates the level of remuneration to be paid to a director, stating that it should be enough to attract and retain the directors needed for the successful operation of an issuer, but not more than is necessary to achieve that goal. Also, no director should be involved in deciding his own remuneration. CP B.1.1 states that issuers should establish a remuneration committee consisting of a majority of INEDs, with specified terms of reference. CP B.1.2 states that the committee should, if required, have access to professional advice. CP B.1.3 sets out the items that should be included in the committee's terms of reference. CP B.1.3(b) states that the remuneration committee should make recommendations on INEDs' and NEDs' remuneration to the board. Finally, RBP B.1.8 states that where the board approves remuneration/compensation in contravention of the advice of the remuneration committee, the board should disclose its reasons for doing so in its next annual report.

#### HKEx Proposals

In formulating their proposals for reform of the rules regarding remuneration committees, HKEx were mindful of the need to ensure the independence of the committee, so that remuneration may be set at a level that benefits the company as a whole. With this primary aim in mind their proposals are as follows:

* The introduction of Rule 3.25, obliging issuers to establish a remuneration committee with a majority of INEDs as members and chaired by an INED. As a result of this new Rule, CP B.1.1 will be deleted.
* The moving of the requirement for a remuneration committee to have written terms of reference from the Code (CP B.1.1) to Rule 3.26.
* The addition of new Rule 3.27, which obliges an issuer that fails to establish a remuneration committee (or comply with the other requirements in Rules 3.25, 3.26 and 3.27), to immediately publish an announcement explaining this failure and supplying the relevant details. Issuers must then meet the requirement(s) within three months.
* The amendment of CP B.1.2 (re-numbered CP B.1.1) to state that the remuneration committee should have access to professional advice that is "independent". CP B.1.3 (re-numbered CP B.1.2) is to be revised to allow issuers to adopt either a "Model A" [[1]](#footnote-36) or "Model B" [[2]](#footnote-37) remuneration committee structure. An issuer should state in the corporate governance report which model it has adopted.
* HKEx have also requested feedback from market participants on whether RBP B.1.8 should be retained and upgraded to a CP (re-numbered CP B.1.6). This provision will only apply to Model B remuneration committees. Under the new CP B.1.6, if an issuer adopts Model B, it would be obliged to explain in its corporate governance report why the board approves remuneration schemes which the remuneration committee does not. If an issuer fails to comply with this requirement, it would have to disclose the reasons for non-compliance in the corporate governance report.
* The amendment of CP B.1.3(c) (re-numbered CP B.1.2(b)) to delete the term "performance-based". This is to ensure consistency with another proposal of HKEx, discussed later in this newsletter, which seeks to add board evaluation of performance as an RBP. It would be inconsistent for an issuer to "comply or explain" against a performance-based remuneration CP if board evaluation is only an RBP. The proposed CP B.1.2(b) notes that management’s remuneration proposals should be assessed by the remuneration committee "with reference to the board's corporate goals and objectives".

### Nomination Committee

#### Current Regulatory Framework

Nomination Committees are currently regulated though the medium of RBPs. RBP A.4.4 recommends an issuer establish a nomination committee with a majority of INEDs as members. RBP A.4.5 recommends that the terms of reference for a nomination committee include the following duties:

1. reviewing the structure, size and composition of the board on a regular basis and making recommendations to the board on any proposed changes;
2. identifying individuals suitably qualified to become board members and selecting or making recommendations to the board on the selection of individuals nominated for directorships;
3. assessing the independence of independent non-executive directors; and
4. making recommendations to the board on relevant matters relating to the appointment or re appointment of directors and succession planning for directors, in particular the chairman and the chief executive officer.

RBP A.4.6 recommends that the nomination committee make its terms of reference available on request and on the issuer’s website and RBP A.4.7 recommends that issuers provide the nomination committee with sufficient resources.

#### HKEx's Proposals

The Consultation Paper makes it apparent that HKEx consider the role of the nomination committee in regulating the size, structure and composition of the board to be a vital one, and one that is best suited to being performed by an independent committee. The new proposals aim to ensure that the regulatory framework allows nomination committees to fulfil their duties in the most effective manner possible and are as follows:

* To upgrade the requirement to establish a nomination committee (RBP A.4.4) to a CP (re-numbered CP A.5.1) and revise it to the effect that the nomination committee should be chaired by an INED while keeping the recommendation that a majority of its members should be INEDs.
* To upgrade RBP A.4.5 (re-numbered CP A.5.2), regarding the terms of reference for a nomination committee to a CP. Furthermore, HKEx propose amending it to the effect that the nomination committees must review the structure, size and composition of the board at least once a year and that the recommendations derived from these reviews should complement the issuer's corporate strategy.
* To upgrade the recommendation for a nomination committee's terms of reference to be made available (RBP A.4.6) to a CP and amend it to state that the information should be available on both the HKEx and issuer's website. This step alleviates one of HKEx's key concerns with the current regulatory system, the absence of a central repository for this kind of information.
* To upgrade the recommendation for the nomination committee to be given sufficient resources (RBP A.4.7) to a CP and make it explicit that the nomination committee can seek independent professional advice at the issuer's expense.

### Corporate Governance Committee

#### Current Regulatory Framework

At present no requirement exists in the Rules or the Code for a corporate governance committee. The closest provision is RBP A.2.5, which notes that an issuer’s chairman should take responsibility for ensuring that an issuer establishes good corporate governance practices and procedures.

#### HKEx Proposals

The Consultation Paper focuses on the need to ensure that issuers have a committee dedicated to maintaining a sufficient level of compliance with legal, regulatory and corporate governance standards and which is capable of making recommendations to the board regarding these matters. This is particularly the case given the dynamic nature of regulatory norms in this area and the fact that all issuers have different factors they must account for when considering their corporate governance responsibilities.

Mindful of the possibility that creating a new committee may drain time and resources from a company and its directors, HKEx have left issuers with the option of either establishing a dedicated corporate governance committee or expanding the duties of an existing board committee(s). To ensure this level of adaptability, the establishment of a corporate governance committee is formulated as a recommendation (RBP D.3.3).

As regards the composition of a corporate governance committee (or an existing committee or committees performing this function), HKEx intend to ensure, through the creation of a CP (CP D.3.2), that a majority of committee members be INEDs. It is also proposed to attach a note to the CP, stating that a corporate governance committee should have at minimum one member who is an executive director or NED, with sufficient knowledge of the issuer's day-to-day operations. HKEx do not propose to amend the Code to recommend who should chair the committee or stipulate qualifications or minimum levels of experience for its members.

The proposals which HKEx hope will assist issuers in this area are as follows:

The addition, as CP D.3.1, of the following duties for the corporate governance committee (or existing committee(s) performing or sharing this function):

1. to develop and review an issuer's corporate governance procedures and make recommendations thereon to the board;
2. to review and monitor the training and continuous professional development of directors and senior management;
3. to review and monitor the issuer's policies and practices on compliance with legal and regulatory obligations;
4. to develop, review and monitor the code of conduct and compliance manual (if any) applicable to employees and directors; and
5. to review the issuer's compliance with the Code and disclosure in the corporate governance report section of its financial statements.

HKEx have also requested responses from market participants on whether the corporate governance committee (or the committee(s) performing these duties) should submit a written report to the board on its work annually, and, if so, whether the report should be published as part of an issuer's corporate governance report.

### Audit Committee

#### Current Regulatory Framework

RBP C.3.7 recommends that the audit committee's terms of reference include reviewing arrangements for issuer's employees to voice concerns about possible improprieties in financial reporting, internal control and other matters. The audit committee should also devise a system which guarantees the fair and independent investigations of concerns raised. CP C.3.3(e)(i) obliges the audit committee to meet with external auditors, at minimum, annually. HKEx note specifically that the Rules and Code do not demand an issuer formulate a "whistleblowing" policy.

#### HKEx Proposals

The Consultation Paper is very clear on the importance HKEx attaches to the role of the "whistle blower" and regards the audit committee as the appropriate body for creating and maintaining a system whereby employees and others may raise concerns regarding the issuer’s financial, and other, practices. With these concerns in mind, HKEx propose to:

* Upgrade RBP C.3.7 to a CP.
* CP C.3.3(e)(i) is to be revised, so that instead of once a year, the audit committee should meet at least twice a year with the issuer’s external auditor.
* HKEx have also devised a new RBP C.3.8, stating that the audit committee should establish a whistleblowing procedure for employees and all who deal with the issuer (e.g.customers and suppliers) to raise concerns, in confidence, with the audit committee about possible improprieties in any matter related to the issuer. This procedure should include a strategy to ensure the protection of those raising concerns about the issuer.

## Remuneration Of Directors, Ceo And Senior Management

#### Current Regulatory Framework: Disclosure of the remuneration of directors and five highest paid employees

Appendix 16, paragraph 24 of the Rules obliges an issuer to disclose in its financial statements the remuneration for the previous financial year of individual directors, by name. Issuers are also required under the Rules to disclose, on a no name basis, the aggregate amount rewarded to the five highest paid individuals at the issuer (Appendix 16, paragraph 25). The biographical details of senior management (with the issuer determining who is to be considered senior management) must be disclosed in the annual report, under Appendix 16, paragraph 12 to the Rules. The Code states that a remuneration committee should assess the remuneration of both directors and senior management (CP B.1.3 (re-numbered CP B.1.2)). RBP B.1.7 recommends that issuers disclose senior management remuneration, by name, in their annual reports.

#### HKEx Proposals

The Consultation Paper emphasises HKEx's concern with ensuring sufficient levels of transparency, not just in the remuneration of directors or the five best paid employees, but in the remuneration of senior management and, in particular, the CEO. It is proposed to achieve this enhanced transparency through the following measures:

* Adding paragraph 25A to Appendix 16, requiring issuers to disclose senior management remuneration by band. It is also proposed that the disclosure of sums received by senior management should be the same as for a director and sales commission paid or payable to senior management should be publicised in financial statements. Senior management is defined as the same persons whose biographical details are disclosed under the Rules (Appendix 16, paragraph 12).
* Amending paragraph 24 of Appendix 16 to state that the issuer should disclose the CEO's remuneration (if he is not a director) by name.
* Upgrading RBP B.1.6 to a CP (re-numbered CP B.1.5).
* Retaining the current recommendation (RBP B.1.7) that issuers disclose senior management remuneration by name in their annual report and accounts.

### Board Evaluation

#### Current Regulatory Framework

No obligation exists in either the Code or the Rules to evaluate board performance.

#### HKEx Proposals

HKEx believe board evaluation to be vital to enhanced board performance and effective governance, as it ensures that directors focus on their duties and responsibilities. As board evaluation mechanisms are new to many companies in Hong Kong, HKEx propose to introduce them first as RBP B.1.8, recommending that issuers conduct regular evaluations of their own, and individual directors', performance.

## Board Meetings

### Dealing with a Situation where there is a Conflict of Interest by a Physical Board Meeting Rather than by a Written Board Resolution

#### Current Regulatory Requirements

CP A.1.8 states that if a substantial shareholder or a director has a conflict of interest in a matter to be considered by the board which is material, the matter should not be dealt with by circulation or by a committee and a board meeting should be held.

#### HKEx Proposals

Despite concerns being raised regarding the usefulness of this CP, with doubts being expressed as to the need for a meeting in the circumstances of a connected transaction, it is to be retained and renumbered as CP A 1.7. A note is to be added, stating that attendance at a board meeting by electronic means, including telephonic or video conferencing, equates to physical attendance.

### Directors' Attendance at Board Meetings

#### Current Regulatory Framework

Attendance is governed at present by Paragraph 2(c)(iii) of Appendix 23 to the Rules, which requires disclosure of each director's attendance at board meetings by name. HKEx note that there is currently no Rule governing alternate directors' attendance at board meetings.

#### HKEx Proposals

The Consultation Paper contains the following proposals in respect of directors' attendance at board meetings:

* The introduction of two new notes to paragraph 2(c) of Appendix 23 (renumbered paragraph I(c) in Appendix 14), stating that: (a) only attendance at board meetings by a director in person or attendance by electronic means such as telephonic or video-conferencing should be counted, and (b) if a director is appointed part way during a financial year, his attendance should be calculated with reference to the meetings occurring during his tenure.
* The introduction of a new requirement (paragraph I(d) in Appendix 14) that an alternate director's attendance at board or committee meetings should not be considered attendance by the director himself. An issuer is to disclose, for each named director, the number of board or committee meetings he attended and separately the number of board or committee meetings attended by his alternate.

### Removing Five Percent Threshold for Voting on a Resolution in Which a Director has an Interest

#### Current Regulatory Framework

Rule 13.44 bars a director of the issuer from voting on any board resolution approving any contract/arrangement/proposal in which he or any of his associates has a material interest, and also prohibits that director from being counted as part of the quorum present at the meeting regarding such a contract/arrangement/proposal. Appendix 3 of the Rules details the required form and contents of an issuer's articles of association and paragraph 4(1) prohibits a director from voting on a board resolution, for the approval of a proposed transaction, in which he is interested. Paragraph (3) of Note 1 in Appendix 3 exempts a director from this requirement in certain situations. For example it permits issuers' articles to state that a director may vote on a board resolution for a proposed transaction with a company, where he is beneficially interested in no more than 5% of that company’s issued shares or voting rights.

#### HKEx Proposals

HKEx is strongly critical of the present regime, stating that the rules in this area "do not promote good corporate governance". The 5% exemption does not prevent a director with what HKEx consider to be "a material interest" in a transaction from voting on that transaction. As a result the exemption in Rule 13.44 is to be removed.

## Chairman And CEO

#### Current Regulatory Framework

CPA 2-2.3 regulate the division of power between the board and management at a day to day level and mandates that the Chairman and CEO not be the same person. RBP 2.4 to 2.9 set out the responsibilities of the Chairman, for instance RBP A.2.5 states that the chairman should take responsibility for ensuring that good corporate governance practices and procedures are established.

#### HKEx's Proposals

The Consultation Paper stresses the need for a regulatory framework which differentiates between the board’s responsibilities and the day to day management of the business. Enshrining the importance of the role of the chairman as leader of the board is also underlined as a regulatory aim. These goals are to be attained through the following reforms:

* The revision of Code Principle A.2 to remove the words "at a board level";
* The amendment of CP A.2.3 to add "accurate" and "clear" to describe the information to be received by the directors; and
* The upgrading of RBPs A.2.4 to A.2.9 to CPs, with minor amendments being made to the current wording.

## Notifying Director Change And Disclosure Of Director’s Information

#### Current Regulatory Framework

Rule 13.51(2) demands issuers immediately inform the Exchange and simultaneously announce, as soon as practicable, when they appoint or re-designate a director or supervisor or when a director or supervisor resigns. Part (o) of that Rule mandates the information which must be contained in such announcements, which includes disclosure of any judgments against the person for fraud, breach of duty or other misconduct by him towards an entity he was involved in forming or managing.

Rule 13.51B(2) states that if there is a change in any of the information required to be disclosed under (amongst others) Rule 13.51(2)(h) during the course of a director's or supervisor's term of office, the issuer must inform the Exchange and publish an announcement concerning that change. Rule 13.51B(3)(c) states that in respect of Rule 13.51(2)(h), an issuer does not need to disclose any sanction imposed by the Exchange.

RBP A.3.3 encourages an issuer to maintain on its website an updated list of its directors identifying their role and function and whether they are INEDs.

#### HKEx Proposals

HKEx identify the absence of a requirement to disclose the information specified under Rule 13.51 (2) when a director retires or is removed by the issuer or in respect of CEOs that are not directors as weaknesses in the regulations. Concerns are also expressed that Rule 13.51(2)(o) casts an insufficiently broad net, as it relates only to directors activities towards particular companies. The proposals to improve regulation in this area are as follows:

* To amend Rule 13.51(2) so that it applies to non director CEOs and the removal/retirement of directors and supervisors, and to extend Rule 13.51(2)(o) to cover all civil judgements of fraud, breach of duty or misconduct involving dishonesty.
* To modify Rule 13.51B(3)(c) in order to make clear that an issuer will not need to disclose any sanction imposed on it by the Exchange.
* To upgrade RBP A.3.3 to a CP and necessitate the publication of directors' information on the HKEx website. This updated list should be published every time there is a change.

### Providing Management Accounts or Management Updates to the Board

#### Current Regulatory Framework

None at present.

#### HKEx Proposals

In the Consultation Paper, HKEx state that if board members receive management accounts or management updates on a regular basis they will have a better understanding of the company's financial performance and position and, as a result, be better able to perform their duties. Therefore HKEx propose to introduce a new CP, CP C.12, recommending that issuers provide their board with monthly updates which present a balanced and understandable assessment of the issuer's performance and current financial position. These may include monthly management accounts and management updates.

### Next Day Disclosure for a Director Exercising an Option in the Issuer or the Issuer's Subsidiaries

#### Current Regulatory Framework

Rule 13.25A(1) imposes an obligation on issuers to publish a Next Day Disclosure Return on changes in an issuer's issued share capital. The events which trigger this obligation include the exercise of an option for shares in the issuer by a director or a director of any of its subsidiaries. Rule 13.25A(3) also requires issuers to publish a Next Day Disclosure Return after the exercise of an option for shares in the issuer by persons other than its directors or any of its subsidiaries if the change (individually or in aggregate) in the issuer's share capital is 5% or more, when compared with its last Monthly Return.

#### HKEx Proposals

The Consultation Paper notes the submissions by market participants that these rules place a difficult burden on large corporations, particularly with regard to the activities of subsidiaries and in an effort to alleviate these problems propose amending the Rules in the following fashion:

* Revising the Rules in order to remove the obligation on issuers to publish a Next Day Disclosure Return subsequent to the exercise of an option for shares in the issuer by a director of its subsidiaries.
* Revising the Rules to the effect that options in the issuer exercised by a director of its subsidiaries only trigger a requirement for an announcement if the change in its share capital, individually or when aggregated with other events, is 5% or more since its last Monthly Return.

### Disclosing Long Term Basis on which an Issuer Generates or Preserves Business Value

#### Current Regulatory Framework

Neither the Rules nor the Code oblige an issuer to disclose the long term basis on which business value is generated or preserved.

#### HKEx Proposals

HKEx consider it a tenet of good governance for an issuer to embrace transparency and inform its shareholders what the corporate strategy is and where funds are being invested. To this end the Consultation Paper recommends the introduction of a new CP, CP C.1.4, declaring directors should include in the issuer's annual report an explanation of how the company generates or preserves value in the long term (the business model) and how the company means to meet its goals (corporate strategy). This explanation should be included in a separate statement containing a discussion and analysis of the group's performance.

### Director's Insurance

#### Current Regulatory Framework

RBP A.19 recommends that issuers organise adequate insurance cover for its directors against legal action.

#### HKEx Proposals

The importance for directors, issuers, shareholders and claimants of adequate insurance is underlined in the Consultation Paper and in order to reinforce the value of such insurance in the minds of market participants, HKEx propose to upgrade RBP A.1.9 to a CP (re-numbered CP A.1.8) and add the words "adequate and general" to describe the insurance issuers should provide for directors.

## The Proposed Amendments: Shareholders

### Notice of Meeting and Bundling of Resolutions

#### Current Regulatory Framework

CP E.1.1 states that for each substantially separate issue at a general meeting, a separate resolution should be proposed by the chairman of that meeting.

#### HKEx Proposals

In an effort to avoid the loss of transparent communication between issuers and shareholders, which can occur through the bundling of important resolutions with technical, less important ones, HKEx intend to clarify the effect of CP E.1.1 by revising it to the effect that issuers should avoid "bundling" resolutions, unless the resolutions are interdependent and linked so as to form one significant proposal. Where the resolutions are "bundled", issuers should make clear, in the notice of the meeting, why this is the case and what the material implications of bundling are.

### Voting by Poll

#### Current Regulatory Framework

* Rule 13.39(4) states that any vote by shareholders at a general meeting must be taken by poll.
* Rule 13.39(5) requires an issuer to announce general meeting poll results and specifies what is to be included in these results.
* Rule 13.40 sets out the Rules under which parties must abstain from voting in favour of a resolution. There are also Rules which prohibit certain parties from voting on a resolution at a general meeting. For example, connected persons with a material interest in a connected transaction are prohibited from voting on a resolution to approve the transaction (Rule 14A.18(1)).
* CP E.2.1 states that at the commencement of a general meeting, the issuer's chairman should ensure that an explanation is provided of the detailed procedures for conducting a poll.

#### HKEx Proposals

In order to increase the efficiency and effectiveness of the general meeting, HKEx have recommended the following changes in the Consultation Paper:

* Amending Rule 13.39(4), to the effect that the chairman may decide whether a resolution on a procedural and administrative matter should be excluded from the requirement for voting by poll, in the hopes of removing an unnecessary burden which the current Rules place upon issuers. A Note will also be appended to the Rule, stating that procedural and administrative matters are those which: (a) do not appear on the agenda of the notice of general meeting or any supplementary circular to shareholders; and (b) relate to the chairman's duties to maintain the orderly conduct of the meeting and/or allow the business of the meeting to be properly and effectively dealt with, whilst allowing all shareholders a reasonable opportunity to express their views. Examples of such matters are provided by HKEx in the Consultation Paper and include a resolution to adjourn the meeting, for example at the end of the AGM to announce results.
* Amending Rule 13.39(5) in order to make explicit the disclosure requirements, specifying that an announcement by an issuer of poll results must include (a) shares entitling the holder to attend and vote on a resolution at the meeting, (b) shares entitling the holder to attend and abstain from voting in favour as set out in Rule 13.40, (c) shares of holders that are required under the Listing Rules to abstain from voting; and (d) shares represented by actual votes for or against a resolution.
* Removing the words "at the commencement of the meeting" from CP E.2.1, for the sake of enhanced clarity.

### Shareholders' Approval to Appoint and Remove an Auditor

#### Current Regulatory Framework

The Rules demand that issuers announce a change of auditor, but do not specifically mandate their appointment, nor do they necessitate shareholders' approval to remove an issuer's auditor before the end of her term of office. However Section 131 of the Hong Kong Companies Ordinance obliges every company to appoint an auditor(s) at their AGM and notes that the auditor can be removed at any time by ordinary resolution.

#### HKEx Proposals

Although HKEx recognise the advantages of not requiring shareholder approval for the removal of auditors, e.g. underperforming ones can be disposed of quickly, the conclusion reached in the Consultation Paper is that the dangers of an issuer removing an auditor to avert the release of damaging information are too great. To prevent this HKEx propose the insertion of a new Rule 13.88, necessitating shareholders’ approval at a general meeting of any proposal to appoint an auditor or to remove him before the end of his term of office.

Under the proposed Rule, where the issuer seeks to dispose of the auditor, it must send a circular to shareholders containing any written representations from the auditor. The auditor also has to be permitted to make a written and/or verbal representation at the general meeting convened to remove him.

### Directors' Attendance at Meetings

#### Current Regulatory Framework

* RBP A.5.7 states that NEDs should regularly attend and actively participate in board meetings, board committee meetings and general meetings.
* RBP A.5.8 states that NEDs should contribute to an issuer's "strategy and policies".
* CP E.1.2 states that the chairman of the board should attend the annual general meeting and arrange for the chairman of the audit, remuneration and nomination committees to be available to answer questions at the meeting.

#### HKEx Proposals

The Consultation Paper reveals HKEx's determination to ensure that NEDs, including INEDs, play an active and informed role in the life of the company and are available at general meetings to answer to shareholders. These concerns apply also to the chairman and the chairs of all of the issuer's committees. To create a situation where directors are encouraged to live up to these aspirations, HKEx propose the following:

* Upgrading RBPs A.5.7 and A.5.8 (re-numbered CP A.6.7 and CP A.6.8) to CPs and explicitly stating that NEDs, including INEDs, should attend meetings and contribute to the issuer's strategy and policies.
* Introducing a new mandatory disclosure obligation in Appendix 23 (re-numbered paragraph I(c) of Appendix 14) stating that an issuer must disclose details of attendance at general meetings of each director by name.
* Revising CP E.1.2 to add "any other committees" in the existing wording, to ensure all the issuers' committees are affected by the new framework.

### Auditors' Attendance at General Meetings

#### Current Regulatory Framework

At present there are no rules obliging or recommending auditors to attend general meetings. They are however entitled to attend, receive information concerning and address general meetings under the Companies Ordinance.

#### HKEx Proposals

HKEx recognise and discuss the possible problems which may arise from auditors attending general meetings, such as their being drawn into detailed question and answer sessions with ill informed and disgruntled shareholders on inappropriate topics. However HKEx believe that this may be avoided by the issuer explaining to shareholders the limitations of the auditor's role and that the benefits of having an auditor present to discuss the audit outweigh the dangers. HKEx thus propose to include a statement in CP E.1.2 that management should ensure the external auditor attend the annual general meeting to answer questions about the conduct of the audit, the preparation and content of the auditors' report, the accounting policies and auditor independence.

### Shareholders' Rights

#### Current Regulatory Framework

Paragraph 3(b) of Appendix 23 to the Listing Rules recommends disclosure of shareholders' rights regarding the methods by which shareholders can call an EGM, the ways in which enquiries can be submitted effectively to the board and the procedures for successfully putting forward proposals at shareholders' meetings.

#### HKEx Proposals

As part of the general drive to improve transparency evident throughout the Consultation Paper, HKEx aim to upgrade the disclosure requirements of shareholders' rights under paragraph 3 (b) of Appendix 23 from "recommended" to "mandatory", (renumbered paragraph O of Appendix 14).

## Communication With Shareholders

### Establishing A Communication Policy

#### Current Regulatory Framework

There is currently no obligation in the Code or the Rules to create a communication policy.

#### HKEx Proposals

The Consultation Paper notes that a recurring failing identified at disciplinary hearings is the absence of a dedicated communication policy between shareholders and the issuer. Such a policy, according to HKEx, is vital in ensuring that shareholders are aware of and can exercise their rights in an informed and effective manner. It should provide shareholders with the information they require in a timely fashion, make participation for shareholders in general meetings achievable, ensure the right personnel are available to answer their queries and provide a means for shareholders to request public information from management and directors. To this end, HKEx propose a new CP E.1.4 recommending that the board should establish a shareholder communication policy that is regularly reviewed by the board to verify its effectiveness.

### Publishing Constitutional Documents on the Issuer's Website

#### Current Regulatory Framework

At present there is no regulatory framework for the publication of such documents on the issuer's website.

#### HKEx Proposals

Again HKEx touch on the issue of transparency, noting how difficult it can be for shareholders to access the issuer's constitutional documents, despite their huge importance. To alleviate this concern, HKEx intend to add a new Rule 13.90 requiring an issuer to publish its constitutional documents, in an up to date consolidated version, on its own website, and on the HKEx website, on a continuous basis.

### Publishing Procedures for Election of Directors

#### Current Regulatory Framework

At present there is no regulatory framework for the publication of the procedures for the election of directors.

#### HKEx Proposals

As a further part of their strive for greater transparency, HKEx propose adding new Rule 13.51D, requiring an issuer to publish, on its website, the procedures which shareholders must follow when proposing an individual for election as a director.

### Disclosing Major Changes to Constitutional Documents:

#### Current Regulatory Framework

Paragraph 3(c)(i) of Appendix 23 recommends disclosure of "any significant changes in the listed issuer's articles of association during the year".

#### HKEx Proposals

Although the new proposals contain a requirement, discussed above, that issuers publish current consolidated versions of their articles of association on their own and on the HKEx websites, HKEx consider it imperative for investors that any major changes to these documents be highlighted. To achieve this aim, HKEx propose upgrading the recommended disclosure in paragraph 3(c)(i) of Appendix 23 to a mandatory disclosure in the corporate governance report (re-numbered paragraph P(a) of Appendix 14).

## The Company Secretary

### Qualifications, Expertise and Training

#### Current Regulatory Framework

Rule 8.17 states that a company secretary must be ordinarily resident in Hong Kong and possess the necessary knowledge and experience to act for the issuer. It also requires the individual to either:

* have been in the position of company secretary of a listed issuer since 1st December 1989,
* be an Ordinary Member of The Hong Kong Institute of Chartered Secretaries, a solicitor, barrister or professional accountant; or
* due to academic, professional or other qualifications or experience, be in a position to satisfy the Exchange of his ability to perform the functions required of him.

The Note to Rule 19.A.16 obliges the issuer to demonstrate to the Exchange that a company secretary without one of the professional qualifications noted above can perform the required functions due to his to academic, professional or other qualifications or experience. Rule 19A.16 exempts the company secretary of a Mainland incorporated issuer from the obligation to be ordinarily resident in Hong Kong, provided he can satisfy the other requirements of Rule 8.17. Neither the Rules nor the Code demand company secretaries undergo any form of training.

#### HKEx Proposals

The Consultation Paper makes it clear that HKEx believe company secretaries have a central role to play in ensuring issuers operate with the highest standards of corporate governance. It also notes that in light of the growing number of issuers listed on the Exchange which operate outside Hong Kong, particularly those from the Mainland, the requirements of Rule 8.17 are too Hong Kong orientated. HKEx’s changes to the regulatory framework for company secretaries, which address these and other issues, are quite extensive and may be summarised as follows:

* The creation of a new section, "Company Secretaries", in Chapter 3 of the Rules. The company secretary's qualifications and experience requirements will be relocated there from Rule 8.17, as Rule 3.28.
* The new Rule 3.28 will focus on academic or professional qualifications and/or relevant experience as the key factors to be assessed by the Exchange when deciding whether a person is capable of performing company secretary functions. A note will be appended to Rule 3.28, providing detailed guidance on how the Exchange will perform this assessment.
* The removal of the requirement that a company secretary be ordinarily resident in Hong Kong.
* The repealing of Rule 19A.16, meaning that company secretaries of Mainland issuers would be subject to the same rules as those of all other issuers.
* The addition of Rule 3.29, imposing 15 hours of continuing professional education in every financial year on company secretaries. A detailed implementation timetable for this requirement is proposed, in order to allow experienced company secretaries sufficient leeway in complying with the new Rule.

### New Section in Code on Company Secretary

#### Current Regulatory Framework

Neither the Rules nor the Code define a company secretary’s role and responsibilities. However CP A.1.4 declares that all directors should have access to the advice and services of the company secretary, in order to ensure board procedures, rules and regulations are followed.

#### HKEx Proposals

HKEx bemoan the fact that despite the importance of the company secretary’s role and duties, these are not defined in the Code. Additionally, board members may not appreciate the crucial part played by the company secretary. Concerns are also raised in the Consultation Paper regarding the use of external secretarial service providers, as these may lack crucial insider knowledge regarding the operation of the issuer. These issues are addressed by HKEx in the following manner:

* The insertion of a new section F of the Code entitled "Company Secretary", setting out the company secretary's role and responsibilities.
* The creation of a new CP F.1.1, stating that the company secretary should be an employee of the issuer, with a current knowledge of its affairs. Should an external service provider be engaged as company secretary, the issuer should identify to it a sufficiently senior individual (e.g. chief legal counsel or chief financial officer) as a point of contact.
* The addition of a new CP F.1.2, declaring that the board should approve the selection, appointment or dismissal of the company secretary, in the hope that this will highlight the significance of the company secretary to the board. It is proposed to attach a note to this CP, recommending the holding of a physical board meeting to discuss the dismissal of the company secretary and advising against dealing with this issue via written resolution.
* A new CP F.1.3 stating that the company secretary should report to the board chairman and/or the chief executive officer.
* The relocation of existing CP A.1.4 to the new section on company secretaries as CP F.1.4.
* The addition of new CP F.1.5, recommending the company secretary keep a record of the training undertaken by directors for each financial year under A.5.5 (re-numbered CP A.6.5).

## Proposed Non-Substantive Amendments

The Consultation Paper also includes a number of non-substantive amendments to the regulatory framework and these may be summarised as follows:

* Defining the term "announcement and announce" in the Rules as "means publication of the announcement in accordance with rule 2.07C".
* Amending Rule 3.06(1) to demand issuers' authorised representatives provide their mobile and other telephone numbers, email and correspondence addresses and other contact details as the Exchange may prescribe periodically.
* The merging of Appendix 23 of the Listing Rules, which requires issuers to include a Corporate Governance Report regarding compliance with the code in the summary financial report prepared by the board of directors and in the annual report, into Appendix 14. This will make the Rules more user friendly, by removing the requirement to constantly cross refer between Appendix 23 and Appendix 14.

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1. In Model A, a remuneration committee will have the authority delegated by the board to determine the specific remuneration packages of executive directors and senior management. [↑](#footnote-ref-36)
2. In Model B, the remuneration committee will review the proposals made by the management on the remuneration of executive directors and senior management, and make recommendations to the board. The board will have the final authority to approve the recommendations made by the committee. The board may ask the remuneration committee to reconsider its recommendations. [↑](#footnote-ref-37)