Growing Asia's Markets

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Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square
8 Connaught Place
Central, Hong Kong

ASIFMA AMG Response to HKEx's Review of Corporate Governance Code and Related Listing Rules

The below responses have been submitted to the Hong Kong Exchanges and Clearing Limited (**"HKEx"**) online system on or before 16 August 2024.

[Note to members: CP = Code Provisions to which companies must "comply or explain" under the Corporate Governance Code, MDR = Mandatory Disclosure Requirement, RBP = Recommended Best Practices]

Q1. Do you agree with our proposal to introduce a new CP requiring issuers without an independent board chair to designate one INED as a Lead INED to enhance engagement with investors and shareholders? Please provide reasons for your views.

YES

On behalf of the Asset Management Group ("AAMG") of Asia Securities Industry & Financial Markets Association ("ASIFMA"), we express the views of our members who are predominantly global asset managers.

We see a continued trend of corporate governance enhancement measures globally as evidenced in markets such as Australia, Japan, Malaysia, Singapore and the UK. Corporate governance reform is therefore necessary to ensure that Hong Kong remains at the forefront of Asian developments. Given the lack of liquidity in the Hong Kong market, such reforms can be a part of broader measures to enhance the vibrancy, competitiveness and therefore attractiveness of the Hong Kong market to global investment capital. A "business as usual" approach will be insufficient to secure Hong Kong's status as an international finance centre.

*In this regard, we welcome and strongly endorse the latest review of and proposed enhancements to the Corporate Governance Code by the Hong Kong Exchanges and Clearing Limited (**"HKEx"**). We would supplement that the various proposals represent a corporate governance reform package. Even though responses are sought per individual proposals, it is vital that as much as*

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possible, the proposals are contemplated and implemented in their totality. If enough individual proposals are struck down, the effectiveness of those other reform measures that are implemented would be diluted or negated.

In our members' experience, boards are most effective at overseeing and advising management when there is a senior independent board leader. Many of our members continue to advocate for the appointment of a separate and independent board chair. Until that time, we support the designation of one INED as a Lead INED for issuers without an independent board chair. This is in line with similar measures introduced in Australia and Singapore.

It is important that the Lead INED role is vested with sufficient authority to carry out its intended responsibilities, and that HKEx provide guidance on how the responsibilities and authority of a Lead INED differs from that of a board chair, especially in a case where the board chair is conflicted.

Role of the Lead INED and institutional investors' expectations

The appointment of a Lead INED is advocated for by the International Corporate Governance Network ("ICGN") and Council of Institutional Investors. Both are established international investor-led organizations that promote effective standards of corporate governance and investor stewardship.

The role of the Lead INED is to enhance the effectiveness of the independent members of the board through shaping the agenda and ensuring adequate INED participation in board deliberations.

Board interaction: *The Lead INED strengthens communication amongst INEDs, and acts as a moderator between the INEDs and other board members as well as senior management executives, which reinforces the independent voices of the board, rather than creating a hierarchy among INEDs.*

Communication channel: *The Lead INED also provides a clear point of contact and accountability for minority shareholders, especially when a lot of issuers' boards in Hong Kong have the dominating presence of a controlling shareholder or founding family.*

Long-term investors tend to benefit when a Lead INED, or equivalent, is available to shareholders in situations where an INED is better placed to provide details of an issuer's approach on a particular issue. We would encourage a Lead INED to communicate with shareholders on board-level issues, including board effectiveness, the board's role in corporate strategy and sustainability, and overseeing material risk management, especially issues that involve conflicts of interest such as executive remuneration and related-party transactions. Long-term investors may also focus engagement on issues material to an issuer's business model and how it generates long-term financial value.

The role is also useful for direct interaction with other key stakeholders that contribute to an issuer's long-term success. It can be helpful for Lead INEDs to understand key stakeholder views so they can better engage management on the related risks and opportunities.

Adoption considerations

Comply or explain approach: *We are concerned that a CP allows issuers too much leeway to "explain" rather than "comply". Issuers could provide a range of justifications evidencing sufficient communication channels to investors. For example, using investor relations to relay investor feedback back to INEDs is neither a sufficient substitute for having a Lead INED nor equivalent to allowing access to INEDs.*

Designation versus appointment: *We would note that where the issuer has the ability to designate an INED as the Lead INED, there is the risk they will cherry pick the most 'friendly' INED for the role. We believe that ideally it should be shareholders who vote on the Lead INED.*

Non-rotation: *Where Lead INED are in place, our members have sometimes seen the position being rotated amongst incumbent INEDs on an annual basis, which we believe undermines the effectiveness and accountability of the Lead INED. Our members would like to see measures in place to ensure that the role is held by a director for a sufficient amount of time to build the necessary relationships, skills and expertise for the initiative to be effective.*

Issuer size: *Our members see the appointment of a Lead INED to be equally important for large as well as smaller issuers, as smaller issuers may just be as likely to engage in related-party transactions that investors would engage on, and access to INEDs is important in such scenarios.*

If the HKEx were inclined to phase-in the adoption of Lead INEDs for large issuers first considering the readiness of smaller issuers, then we would suggest that a Lead INED be made mandatory for large issuers without an independent board chair.

<u>Majority independence</u>

We would take the opportunity to highlight that some of our members support increasing the minimum board independence level to majority independence – this is especially important for issuers without an independent board chair as an effective counterbalancing mechanism. In India, for example, at least half of the board is required to be independent when the chair is not independent.

Q2. Regarding continuous professional development for directors, do you agree with our proposals to:

(a) Make continuous professional development mandatory for all existing directors, without specifying a minimum number of training hours?

Please provide reasons for your views.

YES

We believe that mandatory professional development requirements are a positive step and should not be overly prescriptive. The board should be given sufficient flexibility to design and implement a training plan that is best suited for its own circumstances whilst being provided with adequate training resources from HKEx. This should include pre-selected training resources to equip directors with the necessary skills and knowledge to fulfill their duties, particularly those in relation to external board members.

On the other hand, one member notes that specifying hours and type of training is helpful in reducing ambiguity and helps benchmark a particular director's performance against other directors.

Our members observe that it is often the immediate family and relatives who commits offences in relation to notifiable or connected transactions. We recommend that training resources from HKEx on related listing rules be open to directors and top executives' immediate family and relatives. This should constitute a RBP to encourage companies' adoption of such training for the relevant parties.

(b) Require First-time Directors to complete a minimum of 24 hours of training within 18 months following their appointment?

Please provide reasons for your views.

YES

One member notes that specifying hours and type of training is helpful in reducing ambiguity. To broaden the talent pool to directors outside Hong Kong, there may be flexibility for a director of an issuer listed on an exchange with comparable corporate governance rules and enforcement, even if they are defined as a "First-time Director", may be allowed certain exemptions.

(c) Define "First-time Directors" to mean directors who (i) are appointed as a director of an issuer listed on the Exchange for the first time; or (ii) have not served as a director of an issuer listed on the Exchange for a period of three years or more prior to their appointment?

Please provide reasons for your views.

YES

We agree that First-time Directors should include those in both circumstances described. As the Listing Rules may change, it is important that up-to-date training is undertaken to ensure the director's ability to carry out their duties properly.

(d) Specify the specific topics that must be covered under the continuous professional development requirement?

Please provide reasons for your views.

YES

The topics should ensure that directors can fulfill their duties, particularly those in relation to external board members, as well as the topic of ESG and sustainability.

Q3. Do you agree with the proposed consequential changes to Principle C.1 and CP C.1.1 of the CG Code? Please provide reasons for your views.

[no response]

Q4. Do you agree with our proposal to upgrade the current RBP to a CP requiring issuers to conduct regular board performance reviews at least every two years and make disclosure as set out in CP B.1.4? Please provide reasons for your views.

YES

Q5. Do you agree with our proposal to introduce a new CP requiring issuers to maintain a board skills matrix and make disclosure set out in CP B.1.5? Please provide reasons for your views.

YES

In responding to the 2021 HKEx Consultation Paper on Review of Corporate Governance Code and Related Listing Rules, we had suggested the merits of a board skills matrix detailing board members' skills and experience, which can help long-term investors to understand what skills each director is contributing to the board and potentially any potential gaps to be filled. We welcome the introduction of the CP in relation to this measure. We would also suggest that HKEx require issuers to provide explanatory notes to substantiate the skill mapping process, for example, the experiences which have equipped a director with a particular area of expertise that is mapped.

Q6. In relation to our proposal to introduce a "hard cap" of six listed issuer directorships that INEDs may hold, do you agree:

(a) With the hard cap to ensure that INEDs are able to devote sufficient time to carry out the work of the listed issuers?

Please provide reasons for your views.

YES

In an increasingly complex world, the opportunities and external threats, from digitalisation and automation to climate change, facing an issuer are numerous. Accordingly, the role and expectations of a director are increasing. Directors must be able to commit an appropriate amount of time to board and committee matters.

A number of studies including 'Director Overboarding: Global Trends, Definitions, and Impact' conducted by ISS Analytics (https://www.isscorporatesolutions.com/library/director-overboarding-global-trends-definitions-and-impact/) have indicated a correlation between overboarding and board underperformance. In order to carry out their responsibilities effectively, directors must be able to commit an appropriate amount of time to board matters. We believe that a "hard cap" is the most practical measure to ensure this.

Five equivalent directorships cap: *Many of our members still consider six listed issuer directorships to be excessive. In this regard, we note that the CSRC has most recently introduced a more stringent hard cap of three listed issuer directorships, aligning with the ICGN Global Governance Principles which recommends that "an individual director should not hold more than three directorships of any sort, and this should be substantially less for executive directors, as well as for the board chair and committee chairs."*

We would suggest that HKEx lower the proposed hard cap to ***five equivalent directorships*** *(refer to investor practices below) and provide more granularity about the types of directorships that are incorporated into the hard cap.*

Institutional investors' guidelines and practices: *Currently, our members will consider the type and nature of board directorships held by directors. Various examples of our members' corporate governance principles, proxy voting guidelines, and expectations include, i) the chair of committees, especially an audit committee which meets quarterly, is considered as holding two directorships, ii) a non-executive director should hold no more than four significant issuer directorships at any one time, or six directorships for a related group company, iii) a non-executive chair should serve on no more than two other non-executive issuer boards, iv) an executive director should serve on no more than one additional non-executive issuer board.*

Members will also incorporate the actual attendance rates of directors into their voting decisions.

Directors' commitments: *We note that the SGX Corporate Governance Code adopts the concept of 'Principal commitments' which considers significant time commitments and/or outside activities. This concept is also pertinent In Hong Kong's close-knit business community, where many of the same executive and non-executive directors of issuers are also on the board of public statutory bodies and other organisations, across business, the arts and science, health, education, and sports, including foundations and NGOs. Notwithstanding this, directors may also have other responsibilities for private companies and trusts which are less easily observed. We therefore support a lower of five equivalent directorships.*

Sufficiency of talent pool*: Being a developed international finance centre and trading entrepot, there are many high calibre and experienced professionals who are already working in Hong Kong across different industries. We also note that talent is being encouraged to relocate to Hong Kong as part of the HK Government's top talent initiative. Notwithstanding this, we would argue that issuers especially those with international businesses, should not be excluding the consideration of international talent from their boards.*

We would also encourage HKEx to consider providing incentives to promote new director training and talent development, such as the endorsement and/or funding of director training programmes.

Remuneration of INEDs: *A finding of a consultation conducted by the Hong Kong Monetary Authority in 2016 was that a basic fee of at least HK$400,000 per year, coupled with additional payments for chairing of board committees, would be appropriate for INEDs and commensurate with their responsibilities and workload (https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2016/20161214e1.pdf). Fees at relatively low levels may discourage quality candidates from taking an INED position or indirectly result in the overboarding phenomenon. We encourage the HKEx to conduct a follow-up review of independent directors' compensation.*

(b) With the proposed three-year institution period to implement the hard cap?

Please provide reasons for your views.

NO

We believe that a three-year institution period to implement the hard cap is too long. This is in a similar vein to the three-year implementation period provided by the HKEx to issuers to identify and elect one female director to all-male boards. We would argue that there is plenty of talent in Hong Kong and beyond, and this is a prime opportunity for issuers to enhance the cognitive diversity of their boards, by exploring beyond the usual talent pool.

We are conscious of the need to ensure overall board continuity so we would strongly encourage issuers to plan ahead of time and avoid abrupt changes to their boards which could create gaps in experience and governance. We refer to our response to Question 6 (a) and suggest a phased approach, with a cap of 6 equivalent directorships for financial years commencing on or after 1 January 2025 and 5 equivalent directorships in financial years commencing on or after 1 January 2026. We do not believe this is unreasonable as there are only a limited number of INEDs affected by a hard cap of six directorships.

Q7. Do you agree with the proposal to introduce a new MDR to require the nomination committee to annually assess and disclose its assessment of each director's time commitment and contribution to the board? Please provide reasons for your views.

YES

Some of our members support this proposal as a much-needed disclosure in the Hong Kong market. It would be useful if the HKEx could provide guidance on how to assess directors' contribution as leaving the assessment to issuers might lead to bias.

On the other hand, one of our members believes this is a redundant disclosure requirement as it is unlikely that a nomination committee would evidence that a director, for whom the committee has supported to stay on the board, had not contributed enough or dedicated less than expected time to the board. Rather, the lower hard cap on the number of listed issuer directorships a director may hold (see our response to Question 6) will better serve the purpose of mitigating overboarding issues of directors.

Q8. In relation to our proposal to introduce a "hard cap" of nine years on the tenure of INEDs, beyond which an INED will no longer be considered to be independent, do you agree:

(a) With the proposed hard cap to strengthen board independence?

YES

There are many factors that can impair director independence, of which tenure is one. It is however a measurable and quantifiable factor, which can contribute to the foundations of good corporate governance in Hong Kong. We would argue that this is important for protecting the interests of minority shareholders, and not solely expected to improve company performance. Notwithstanding which, the HKEx may consider conducting research in the local market to evidence correlation and causality between various aspects of corporate governance and company performance.

The ICGN Global Governance Principles support tenure limits of between 8 and 12 years – a range which can take into account individual market differences. In the case of Hong Kong, the findings of the 2016 HKMA consultation cited in our response to Question 6 suggests that independence starts to be questioned when serving on a board for more than 9 years. Finally, the HKSAR Government in maintaining its system of Advisory and Statutory Bodies has a "Six-year Rule" operating in conjunction with a "Six-board Rule" as enunciated in 2009 (https://www.info.gov.hk/gia/general/200906/17/P200906170128.htm#:~:text=%22Six-year%20Rule%22%20means%20not%20appointing%20a%20non-official%20member,more%20than%20six%20ASBs%20at%20any%20one%20time).

*We therefore support the proposed hard cap, with a hard re-designation to non-executive director after 9 years (which includes the time that a director is serving a board pre-IPO). It should not be negotiable to explain why a Long Serving INED is independent. We believe a 9-year cap will **remove subjectivity and simplify the requirements in Hong Kong** and align with Asian markets leading in corporate governance practices.*

We note that a long-tenured INED is not excluded from remaining on a board, especially where their skillset, their knowledge of the issuer and continuity on the board is considered important, but that there is a requirement to re-designate them as a non-executive director.

Interplay of Institutional investors' guidelines and local rules
Many of our members will publish global or regional stewardship principles or investing guidelines that may make reference to a tenure cap range of typically between 9 and 12 years. It is a long-running practice that long-tenured INEDs who exceed these ranges will be reclassified as non-executive directors in our board assessments and this will inform voting decisions.

The range may not appear to be a 'hard and fast rule' but allows for variation between 1) specific issuer considerations and 2) different market dynamics. At an individual issuer board level, we will look across the tenure / board renewal and independence of the board. For example, members may not always vote against long-tenured INEDs if an issuer displays sufficient evidence of board renewal and/or maintains sufficient independence at board and committee levels after reclassifying long-tenured INEDs. On the other hand, some of our members will quite often vote against the non-executive directors, if board and committee independence following reclassification is then below one-third (or even below 50%, for one member). At the market level, where local regulations mandate a lower limit, this lower number will be the actual cap used in our members' board assessments.

(b) That a person can be re-considered as an INED of the same issuer after a two-year cooling-off period?

NO

We do not support the two-year cooling-off period which will undermine the effectiveness of tenure reform and potentially weaken the standing of any INED who has been brought in to 'keep the seat warm' for an incumbent INED. This would also avoid the circumstance of INEDs being rotated across different issuers within a group.

(c) With the proposed three-year transition period in respect of the implementation of the hard cap?

YES

We support orderly board renewal including a three-year transition period to the extent that no long-tenured INED will be re-appointed as INED when the Corporate Governance Code is revised. Accordingly, we would not expect incumbent long-tenured INEDs to be replaced before their current term ends. At the same time, we strongly reiterate that a long-tenured INED is not prevented from remaining on a board but will be re-designated as a non-executive director on reappointment for future term(s), notwithstanding that the size of the board may need to be increased to satisfy board composition requirements in relation to INEDs. In this respect, we would hope that board renewal is done such that board remains manageable in size and may carry out its functions effectively.

Q9. Do you agree with the proposal to require all issuers to disclose the length of tenure of each director in the CG Report? Please provide reasons for your views.

YES

This allows shareholders to understand how long each director has served or will serve on the board. We also suggest that issuers disclose the length of tenure within circulars at the time of election and/or re-election.

Q10. Do you agree with our proposal to introduce a CP requiring issuers to have at least one director of a different gender on the nomination committee? Please provide reasons for your views.

YES

We agree that the addition of one female director to the nomination committee can potentially bring a different perspective and voice in encouraging board, management, as well as broader workforce diversity, equity and inclusion.

Additionally, we would suggest HKEX require the nomination committee to be chaired by an INED aligning with independence practices in other Asian markets, and also considering that the current regulatory regime still allows the board chair (oftentimes also the founder of CEO/executives) to chair the nomination committee.

Q11. Do you agree with our proposal to introduce a Listing Rule to require issuers to have and disclose a diversity policy for their workforce (including senior management)? Please provide reasons for your views.

YES

We support initiatives that encourage and provide transparency on diversity, equity and inclusion in the workplace.

Q12. Do you agree with our proposal to upgrade from a CP to a MDR the requirement on the annual review of the implementation of an issuer's board diversity policy? Please provide reasons for your views.

YES

Issuers need to outline progress against policy criteria or objectives. We wonder if an annual review is too frequent and suggest it should be aligned with the proposed CP to conduct regular board performance reviews at least every two years.

Q13. Do you agree with our proposal to require as a revised MDR separate disclosure of the gender ratio of: (i) senior management; and (ii) the workforce (excluding senior management) in the CG Report? Please provide reasons for your views.

YES

Gender ratios: *Investors see the importance of board gender diversity, as organisational behaviour is heavily influenced by the "tone from the top". Senior management gender diversity is equally important, although it is a less broadly available diversity data point*

Investors would like to see a target of between 30% to 40% of senior management roles held by women, especially from a diversity, equity and inclusion perspective. In certain male-dominated industries, for example, energy and construction, we would recommend that women representation in senior management at least reflect the broader workforce.

We strongly support enhanced disclosures as we believe that better transparency and comparability across issuers, will ultimately lead to improved gender ratios.

Gender pay gaps: *In addition, we consider the measurement and disclosure of gender pay gap to be an even more effective parameter to show a complete picture of an issuer's practices in gender diversity and equity. An issuer may have a relatively equal representation of both genders at each level compared to peers but pay a particular gender group significantly lower. We recommend that the gender pay gaps across different levels be made an MDR.*

On this note, senior management in gender ratio/pay gap disclosure should bear a meaning not narrower than that in an issuer's remuneration policy, especially with respect to sections pertaining to those eligible for stock compensation as senior management.

Q14. Do you agree with our proposal to codify the arrangements during temporary deviations from the requirement for issuers to have directors of different genders on the board as set out in draft MB Rule 13.92(2) in Appendix I? Please provide reasons for your views.

[no response]

Q15. Do you agree with our proposal to:

(a) **emphasise in Principle D.2 the board's responsibility for the issuer's risk management and internal controls and for the (at least) annual reviews of the effectiveness of the risk management and internal control systems; and**

(b) **upgrade the requirement to conduct (at least) annual reviews of the effectiveness of the issuer's risk management and internal control systems to mandatory and require the disclosures set out in MDR paragraph H?**

Please provide reasons for your views.

YES

Risk management and internal controls should be the fundamental concerns of the board.

Q16. Do you agree with our proposal to refine the existing CPs in section D.2 of the CG Code setting out the scope of the (at least) annual reviews of the risk management and internal control systems? Please provide reasons for your views.

[no response]

Q17. Do you agree with our proposal to introduce a new MDR requiring specific disclosure of the issuer's policy on payment of dividends and the board's dividend decisions during the reporting period? Please provide reasons for your views.

YES

We support the MDR on dividend policy and suggest that the scope is widened to a broader disclosure of an issuer's capital allocation policy. We expect issuers to disclose a clear capital allocation policy (cash dividend, share buybacks and cancellations, especially in light of recent changes to the Listing Rules regarding the handling of treasury share) to serve as a sufficient starting point for constructive engagements between issuers and investors.

Q18. Do you agree with our proposal to introduce a Listing Rule requirement for issuers to set a record date to determine the identity of security holders eligible to attend and vote at a general meeting or to receive entitlements? Please provide reasons for your views.

[no response]

Q19. Do you agree with our proposal to codify our recommended disclosures in respect of issuers' modified auditors' opinions into the Listing Rules? Please provide reasons for your views.

[no response]

Q20. Do you agree with our proposal to clarify our expectation of the provision of monthly updates in CP D.1.2 and the note thereto? Please provide reasons for your views.

[no response]

Q21. Do you agree with our proposal to align requirements for the nomination committee, the audit committee and the remuneration committee on establishing written terms of reference for the committee and the arrangements during temporary deviations from requirements as set out in draft Main Board Listing Rules 3.23, 3.27, 3.27B, 3.27C and 8A.28A in Appendix I? Please provide reasons for your views.

[no response]

Q22. Do you agree with the proposed implementation date of financial years commencing on or after 1 January 2025, with transitional arrangements 151 as set out in paragraphs 182 to 183 of the Consultation Paper? Please provide reasons for your views.

[no response]