



CONSULTATION PAPER ON REVIEW OF THE CORPORATE GOVERNANCE CODE AND RELATED LISTING RULES

The Law Society's Submissions

The Stock Exchange of Hong Kong Limited (the "Exchange") issued a consultation paper for the review of the corporate governance code and related listing rules in November 2017 (the "Consultation Paper"). In response thereto, the Law Society provides the following submissions on the consultation questions posed.

Question 1: *Do you agree with the proposed amendment to Code Provision ("CP") A.5.5 as described in paragraph 36? Please give reasons for your views.*

Law Society's response:

While we support the principle behind, it is unclear how the triggering threshold of the seventh directorship is determined, apart from the brief reference in footnote 12 of the Consultation Paper, which refers to ISS¹. The demands of each directorship differs, and a lesser number of directorships involving complex listed companies or situations may be very exacting. Perhaps it is worthwhile considering a qualitative requirement instead, for example, that the board of directors of a listed company (the "Board") has to give a qualitative explanation about how directors devote their time and skills to the Board, having regard to a number of factors including the number of directorship held).

Question 2: *Do you agree with the proposals to upgrade CP A.5.6 to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their corporate governance reports? Please give reasons for your views.*

Law Society's response:

We agree with the proposal.

¹ ISS - the Institutional Shareholder Services, Inc.'s 2016 Benchmark Policy Recommendations for Hong Kong which recommends that it would generally vote for the re-election of directors, unless the nominee sits on a total of more than six public company boards.

Question 3: Do you agree with the proposal to amend CP A.5.5 that it requires the board to state in the circular to shareholders accompanying the resolution to elect the director:

- (i) the process used for identifying the nominee;
- (ii) the perspectives, skills and experience that the person is expected to bring to the board; and
- (iii) how the nominee would contribute to the diversity of the board.

Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 4: Do you agree with the proposal to amend Mandatory Disclosure Requirement L.(d)(ii) as described in paragraph 56? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 5: Do you agree with the proposal to revise Rule 3.13 (3) so that there is a three-year cooling off period for professional advisers before they can be considered independent, instead of the current one year? Please give reasons for your views.

Law Society's response:

The proposed period may be overly restrictive – in an extreme case, a candidate could be rendered “non-independent” under the proposal even though he/she had no relationship with the provision of professional services during the 3-year “look-back” period.

Independence of an independent non-executive director (“INED”) candidate should require factual analysis on a case-by-case basis – in principle, therefore, the time period during which a candidate is regarded as affiliated with a professional adviser should generally be aligned with that of his/her involvement (if any) in the adviser’s services to the issuer provided during the cooling off period.

The proposal may also add challenges in sourcing eligible INEDs and cause companies to lose a valuable source of talents on their boards. It is also noted (from the Consultation Paper) that Singapore and Mainland China only have a one-year ban on former professional advisers, whereas the UK’s ban is only imposed on a “comply or explain” basis. That said, we also take the view that the specific circumstances of Hong Kong must be taken into account, and there is a limit to which international benchmarking could be made. It is not unfair to say that quite a number of listed companies in Hong Kong have experienced difficulties in finding suitable INEDs.

To enhance regulation while not depriving issuers of eligible INED candidates, any additional cooling-off period should be made a CP (rather than a Rule amendment) such that issuers will have to explain the reasons should there be a deviation from the CP.

Question 6: Do you agree with the proposal to revise CP C.3.2 so that there is a three-year cooling off period for a former partner of the issuer's existing audit firm before he can be a member of the issuer's audit committee? Please give reasons for your views.

Law Society's response:

Please see our response to Question 5.

Question 7: Do you agree with the proposal to revise Rule 3.13(4) to introduce a one-year cooling off period for a proposed independent non-executive director ("INED") who has had material interests in the issuer's principal business activities in the past year? Please give reasons for your views.

Law Society's response:

We agree with the proposal in principle.

Question 8: Do you agree with the proposal to introduce a new Recommended Best Practice ("RBP") A.3.3 to recommend disclosure of INEDs' cross-directorships or having significant links with other directors through involvements in other companies or bodies in the Corporate Governance Report? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 9: Do you agree with the proposal to introduce a Note under Rule 3.13 to encourage inclusion of an INED's immediate family members in the assessment of the director's independence? Please give reasons for your views.

Law Society's response:

Somewhat polarized views have been expressed by our members.

Some adopt the view that the net may be cast unnecessarily wide under the proposal, especially since the Note to the existing Rule 3.13(6) already covers family members of an INED candidate. The proposed amendment to Rule 3.13 may also give the impression that a candidate's independence is bound to be compromised by some connections which his/her family member has – this is not necessarily true and is also unfair to the candidate. To balance between perceived independence concerns and actual facts, a CP can be added to require the board of directors of an issuer to explain its reasons where it determines that

a candidate is independent notwithstanding his/her family ties (similar to the UK approach).

On the other hand, the contrary view has been expressed that connections through immediate family members is a real issue in Hong Kong, and INED's immediate family members should be considered in the context of ensuring the director's independence and it should be regulated as a Rule instead of just being a CP. For example, the Rule may provide that the independence status will be taken as compromised unless it could be shown to the Exchange that the potential implications resulting from such ties have been severed.

Question 10: Do you agree with the proposal to adopt the same definition for "immediate family member" as Rule 14A.12(1)(a) as set out in paragraph 81? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 11: Do you agree with the proposal to amend Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 to require an issuer to disclose its nomination policy adopted during the year? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 12: Do you agree with the proposal to amend CP A.6.7 by removing the last sentence of the current wording? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 13: Do you agree with the proposal to revise CP A.2.7 to state that INEDs should meet at least annually with the chairman? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 14: Do you agree with the proposal to introduce CP E.1.5 requiring the issuer to disclose its dividend policy in the annual report? Please give reasons for your views.

Law Society's response:

We agree with the proposal.

Question 15: Do you think that the Rules should be amended to allow shareholders' consent to be implied for electronic dissemination of corporate communications by issuers? Please give reasons for your views.

Law Society's response:

We agree.

The Law Society of Hong Kong
6 December 2017