



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

THE LAW SOCIETY'S SUBMISSIONS

The Stock Exchange of Hong Kong Limited (“Exchange”) issued the “Consultation Paper on Review of Corporate Governance Code and Related Listing Rules” on 14 June 2024 (“Consultation Paper”).

In response, the Law Society provides the following submissions. Unless otherwise defined, the same abbreviations and definitions appearing in the Consultation Paper are used in this paper.

General Observations

We welcome the Hong Kong Government’s efforts to improve the economy and revitalise Hong Kong’s markets. We support strong corporate governance standards for listed and unlisted companies in compliance with Hong Kong law. Against this background, we wish to emphasise that Hong Kong should not adopt proposals that may increase the regulatory burden on listed companies disproportionately which would thereby discourage both new applicants from listing on the Exchange and currently listed companies from retaining their Hong Kong listing status.

In this connection, we note comments made in the proposals in the Consultation Paper are intended to enable Hong Kong to somehow “catch up” with other markets. This is not necessarily the case. In its comparisons, the Exchange does not appear to have emphasised the requirements of the US stock exchanges, the world’s deepest and best valued major markets, where many of its proposals are not part of the rules. Many of the Exchange’s proposals would impose mandatory rules on Hong Kong listed companies, in contrast with many other markets where equivalent measures are only recommendations, or subject to comply or explain, not mandatory rules. We suggest that the Exchange allow listed companies, in particular larger companies, to choose to adopt higher standards in response to stakeholder expectations and cater for the needs of smaller start up and scale up companies, rather than adopt a one size fit all approach.

The Hong Kong market is going through an unprecedented challenging time, and while this is caused by a complex range of factors, we encourage the Exchange to give consideration to making Hong Kong a more friendly and competitive place to do business and creating regulation which encourages companies to list and remain listed in Hong Kong.

We also, in general, welcome and support proposals to strengthen the corporate governance of issuers, including the exercising of effective independent oversight of the board of the issuers by INED¹s. However, INEDs should be properly paid and the level of INED remuneration in Hong Kong tends to fall behind major markets.

It is not realistic to impose incremental obligations on INEDs and expect such obligations to be discharged effectively without INEDs receiving an appropriate level of remuneration. The Exchange may consider conducting a survey on the INED remuneration package. The need to remunerate INEDs at a suitable level may be reflected in the Listing Rules appropriately.

Consultation Questions

Question 1: *Do you agree with our proposal to introduce a new CP² 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.*

Law Society's response:

We note that the proposal will have the advantage of aligning Hong Kong with UK, Australia and Singapore. The purpose is to enable the lead INED to serve as a bridge with investors (especially minority shareholders) where access to the board is inadequate (*see para 27 of the Consultation Paper*). The lead INED will offer a point of contact for shareholders to discuss questions on governance and INED performance (*see para 34 of the Consultation Paper*).

We consider that the proposal should, on balance, be a RBP³ only. First, there may not be a lead INED. In such a case, imposing a hierarchical structure by appointing a lead INED may disrupt the effective functioning of the listed company board. Second, as matters stand, investors do write to the company or the INEDs, and where there are material issues, the INEDs will be involved. We do not see the need to prescribe for a lead INED which may lead to a “box-ticking” approach being adopted without meaningful practical impact. Although the proposal is on a “comply or explain” basis, in practice, this points to compliance.

¹ Independent Non-executive Directors

² Code Provisions under the CG Code

³ Recommended Best Practices under the CG Code

We also note that some concerns raised by the Exchange have already been addressed by other legislation and rule provisions. For instance, pursuant to Appendix C1 Part 2 C.1.6 of the Main Board Rules (and the equivalent in the GEM Rules) currently in force, all INEDs and NEDs⁴ shall participate in shareholders' meetings to ensure constant communication with shareholders. Listed companies are generally encouraged to ensure equal communication to investors and this is especially the case for inside information where such information must be disseminated to the public in an equal and timely manner as stipulated under section 307C of the Securities and Futures Ordinance (Cap. 571 of the laws of Hong Kong).

Question 2: *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?*
- (b) *Require First-time Directors to complete a minimum of 24 hours of training within 18 months following their appointment?*
- (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?*
- (d) *Specify the specific topics that must be covered under the continuous professional development requirement?*

Please provide reasons for your views.

Law Society's response:

- (a) We agree, but subject to the following:
 - (1) Flexibility should be built into the Listing Rules to allow for situations where the individual involved is apparently experienced in and familiar with the duties of a director of a company listed on the Exchange.
 - (2) We do not agree that training details would need to be published in annual reports as required by Appendix C1 Part 1 B(i) (i) to (iv) of the Main Board Rules and the equivalent proposed change to the GEM Rules. The information in an annual report should be relevant and material to investors, and such details do not belong to this category of information. The details may instead be submitted to the Exchange for necessary monitoring if required.

⁴ Non-executive Directors

- (b) We agree.
- (c) We agree with point (i) subject to the condition that experience gathered as a director of a company listed on another stock exchange of international repute should be given due recognition. However, we do not agree with point (ii) which should be considered on a case-by-case basis depending on the circumstances and experience of the individual person.
- (d) The requirement should not be prescriptive. As a general comment, the Listing Rules should not encourage a “box-ticking” approach. Further, there must be flexibility to ensure that the training is relevant and material to the business and situation of the listed company in question.

Question 3: *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.*

Law Society's response:

We agree, but subject to the comments in our answer to Q2 above.

Question 4: *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.*

Law Society's response:

We agree, since this will assist the board of a listed company and strengthen the position of INEDs.

Question 5: *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.*

Law Society's response:

We agree and consider that having a diversity of skills is particularly important in the context of rapid market and economic changes, especially in technology, big data, sanction and governance, and AI.

Question 6: *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?*
- (b) *With the proposed three-year transition period to implement the hard cap?*

Please provide reasons for your views.

Law Society's response:

We agree with both proposals.

Question 7: *Do you agree with the proposal to introduce a new MDR⁵ 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.*

Law Society's response:

Agree. To clarify the requirements, we would propose an amendment to the definition of "significant external time commitments" in the proposed Note to Appendix C1 Part 1 E of the Main Board Rules (and the equivalent in the GEM Rules). It should refer to "the" listed issuer's directorship and not any listed issuer's directorship roles.

Question 8: *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?*
- (b) *That a person can be re-considered as an INED of the same issuer after a two-year cooling-off period?*
- (c) *With the proposed three-year transition period in respect of the implementation of the hard cap?*

Please provide reasons for your views.

Law Society's response:

We fully agree with the need for the INEDs of a company to contribute their independent judgment and expertise for the benefit of the company and in particular minority shareholders. However, we disagree with the proposal to introduce a hard cap

⁵ Mandatory Disclosure Requirements under the CG Code

on the length of an INED's tenure for the reasons below and would consider that the existing rules on long-serving INEDs already strike the right balance.

(1) The length of an INED's tenure does not of itself necessarily impact their independence. We note that under Recommendation 2.3 of the Australian Corporate Governance Code cited by the Exchange in support of this proposal that the Australian Securities Exchange acknowledges that an independent director holding a long tenure alone is not indicative that the independent director is too close to the management of the listed company. It should remain one of the factors for a company to consider taking into account all relevant circumstances when assessing an INED's independence, but it should not be the decisive factor.

(2) The hard cap proposal could potentially have the unintended effect of weakening a company's corporate governance. A company may have to replace high quality INEDs with candidates whose experience and skill set are less appropriate for the company. Also, it would normally take time for INEDs to familiarise with a listed company, and the time required could vary significantly depending on the particular company and industry involved. There are studies on corporate governance which state that it may take roughly six years for independent directors to start contributing to the performance of a listed company.⁶ INEDs who have served on the board for a longer period may possess more in-depth insights into what would be in the best interests of the listed company and its stakeholders.

(3) The proposal would put Hong Kong at a competitive disadvantage against other leading exchanges. For example, there is no hard cap on the length of an INED's tenure under the rules of the New York Stock Exchange, NASDAQ, the London Stock Exchange or the Tokyo Stock Exchange.

(4) INED independence is only one aspect of minority shareholder protection. Hong Kong already has significant minority shareholder protection in place, in particular on connected party transactions.

The existing rules on INEDs already strike the right balance by requiring companies (i) to consider the length of an INED's tenure when assessing his/her independence and (ii) on a comply-or-explain basis, to seek shareholders' approval (by way of a separate resolution and with enhanced disclosures) for the further appointment of a long-serving INED and, in the case of a company whose INEDs are all long-serving, the appointment of a new INED.

In addition, appointment of directors on boards of listed companies operating in regulated industries may be subject to prior approval of the relevant regulatory bodies which could be a lengthy process without certainty that the required approval would eventually be forthcoming. Coupled with the fact that the pool of eligible candidates with the required qualification may already be limited, a cap on the length of tenure could create burden on and increase the risk of non-compliance by listed companies to

⁶ See the paper titled "The Effect of Independent Directors' Characteristics on Firm Performance: Tenure and Multiple Directorships" by Nuria Reguera-Alvarado and Francisco Bravo at <https://doi.org/10.1016/j.ribaf.2017.04.045>

appoint a sufficient number of INEDs when existing INEDs need to retire due to such hard cap.

We also query the basis of setting the cap at nine years. For example, we note from the Consultation Paper that BlackRock and Glass Lewis suggested that directors would not be considered independent after serving on the board for twelve years. A further explanation from the Exchange would be beneficial to understand the rationale behind the nine-year cap.

Additionally, we note the following:

- (a) Proposed Note 5 to Rule 3.13A of the Main Board Rules (and the equivalent in the GEM Rules) refers to directorships in any core connected persons of the listed issuer.
- (b) For large wealthy families, core connected persons could extend to many companies down the chain of ownership. The INED's tenure with such companies may or may not affect his independence, depending on the extent of the connection. This should be assessed on a case-by-case basis.

Question 9: *Do you agree with the proposal to require all issuers to disclose the length of tenure of each director in the CG Report⁷? Please provide reasons for your views.*

Law Society's response:

We agree.

Question 10: *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.*

Law Society's response:

We agree with the diversity, but:

- (1) first, as a general comment, diversity should extend beyond gender diversity, and in many cases, having the right experience and skill set is more important than having the right gender mix (where gender does not itself contribute to the experience or skill set);
- (2) in this connection, the gender diversity requirements under the Rules are becoming increasingly prescriptive. This proposal that there must be a different

⁷ Corporate Governance Report under the Corporate Governance Code as set out in Appendix C1 to the Main Board Listing Rules and Appendix C1 to the GEM Listing Rules ("CG Code")

gender (by which we take to mean male and female if that distinction, which is continuously being diluted, holds) on the nomination committee, may be onerous and may not be particularly relevant for some companies depending on their individual circumstances and board committee composition. As mentioned in point (1) above, appointing persons with the appropriate skill sets is more crucial to maintaining sound board committees;

- (3) the word “gender” should be clarified as this could potentially refer to both social gender (which may be fluid, situational or non-binary) and biological sex, making the regulatory requirements unclear. Referring to the diction under the Sex Discrimination Ordinance (Cap 480 of the Laws of Hong Kong), “sex” is used rather than “gender”;
- (4) we consider that the proposal should, on balance, be made an RBP only. While gender diversity is important, we should take into account other factors, such as whether this should be made a prescriptive requirement when Hong Kong is trying to attract listing candidates from other cultures that may not necessarily share the same values.

Question 11: *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.*

Law Society's response:

We agree. We also repeat our comment that the Listing Rules should consider diversity across various aspects of the board (including skill sets and background) and not just gender diversity. We consider that Appendix C1 Part 1 J(a)(i) of the Main Board Rules (and the equivalent in the GEM Rules) may retain its existing wording.

Question 12: *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.*

Law Society's response:

We refer to the comments above and consider that the proposal should, on balance, be made an RBP only.

Question 13: *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 Report⁸? Please provide reasons for your views.

Law Society's response:

We refer to the comments above and consider that the proposal should, on balance, be made an RBP only.

Question 14: *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.*

Law Society's response:

Please see our comments in our answer to Question 11 above.

Question 15: *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.

Law Society's response:

We agree with both proposals subject to the following:

- (i) Proposed Appendix C1 Part 1 H (a) of the Main Board Rules (and the equivalent in the GEM Rules) refers to risk management and internal controls being “appropriate and effective” for “preventing and detecting **fraud**, misconduct and loss” (emphasis supplied).
- (ii) We consider that the reference to “**fraud**” should be removed as it is not possible to have effective systems to prevent fraud. It is only possible to implement “appropriate” or prudent systems.

⁸ Corporate Governance Report under the Corporate Governance Code as set out in Appendix C1 to the Main Board Listing Rules and Appendix C1 to the GEM Listing Rules (“CG Code”)

- (iii) The same comment applies to the proposed Appendix C1 of Part 2 D.2 of the Main Board Rules (and the equivalent in the GEM Rules).

Question 16: *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.*

Law Society's response:

We agree.

Question 17: *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.*

Law Society's response:

We agree because the information is relevant and material to investors.

Question 18: *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.*

Law Society's response:

We agree to revise the Listing Rules to require issuers to set a record date for general meetings and for receiving entitlements.

Question 19: *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.*

Law Society's response:

We agree.

Question 20: *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.*

Law Society's response:

We agree that the monthly updates in Appendix C1 Part 2 D.1.2 of the Main Board Rules (and the equivalent in the GEM Rules) should include monthly management accounts and management updates and to make clear that directors are entitled to and should request such information if the management does not provide it.

Question 21: *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.*

Law Society's response:

We agree to align nomination committee requirements with existing audit committee and remuneration committee requirements to ensure consistency of approach across these three mandatory board committees.

Question 22: *Do you agree with the proposed implementation date of financial years commencing on or after 1 January 2025, with transitional arrangements as set out in paragraphs 182 to 183 of the Consultation Paper? Please provide reasons for your views.*

Law Society's response:

Subject to our comments above, we agree with the proposed implementation date of financial years commencing on or after 1 January 2025, with transitional arrangements (i.e. a three-year transitional period for the proposed caps on the tenure of overboarding and of Long Serving INEDs so that the proposed Listing Rules will apply from 1 January 2028 onwards (*See Question 6(b) (in respect of overboarding and Question 8(c)(in respect of Long Serving INEDs) of the Consultation Paper*).

**The Law Society of Hong Kong
20 August 2024**