CFA Society Hong Kong

By email (response@hkex.com.hk) and by hand

17 June 2021

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

Dear Sir,

CONSULTATION PAPER –
REVIEW OF CORPORATE GOVERNANCE CODE AND RELATED LISTING RULES

The CFA Society Hong Kong has reviewed the abovenamed consultation paper and our comments on the consultation paper have been summarized in the attached questionnaire for your reference.

We agree to the proposals. However, as certain proposals in the consultation paper do not have proper legal backing, efficiency of these proposals, e.g., the code provisions on the anti-corruption policy and the whistleblowing policy, may be discounted when implemented. Besides, we propose introduction of a board evaluation mechanism which would be useful in assessing whether the issuers have corporate cultures that are in line with their purpose, value and strategy. The board evaluation mechanism is also relevant to some other proposals mentioned in the consultation paper.

In addition, introduction of gender diversity requirements is a good means to promote board diversity. As for the introduction of a code provision to amend the Listing Rules and the ESG Guide to require publication of ESG reports at the same time as publication of annual reports, we consider that sufficient transition time should be given to the issuers such that they will be able to make arrangements to adopt the compressed deadline without compromising the quality of the ESG reports.

Please refer to the duly completed questionnaire for elaboration of our views on the consultation paper. Meanwhile, should you have any questions, please do not hesitate to contact the undersigned at eric.chiang@cfahk.org or 2530 9200.

Yours faithfully,
For and on behalf of
CFA Society Hong Kong

Eric Chiang
Managing Director

Encl.

www.cfahk.org
+852 2521 2543
14/F, BOC Group Life Assurance Tower, 136 Des Voeux Road Central, Hong Kong

Responses of the CFA Society Hong Kong to the Consultation Paper: Review of Corporate Governance Code & Related Listing Rules[i]

Question 1

Do you agree with our proposal to introduce a CP requiring an issuer's board to set culture in alignment with issuer's purpose, value and strategy?[1]

We agree in principle.

Setting out the culture in alignment with issuer's purpose, value and strategy is good and helpful. We observe that larger issuers in Hong Kong are already complying with an elevated CG standards on a voluntary basis, and it is unlikely that they will find it difficult to comply with the new requirement. They may actually embrace the introduction of the requirement as that will give them another good opportunity to demonstrate to investors their core values and culture. However, some smaller issuers may find it burdensome to comply with, and therefore just take a tick-the-box approach to deal with the new requirement. It is important that the true culture of the issuers be reflected in the disclosure. If the issuers just go for form rather than substance for the sake of compliance, the impact of the new requirement would be undermined.

We agree with the statement in the first paragraph of page III-3 of the consultation paper that "The Exchange does not envisage a "one size fits all" approach, and appreciates that effective application of the Principles may be achieved by means other than strict compliance with the code provisions depending on a range of factors, including the issuer's own individual circumstances, the size and complexity of its operations and the nature of the risks and challenges it faces."

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[1] *The CFA Institute has the following additional comments to the question:*

Board Oversight on Code of Ethics

The consultation paper talks about setting up whistleblower and anti-corruption policies. In addition to the policies, we believe that a strong code of ethics is important in driving good behaviour. The board should have oversight on the company's code of ethics, and use the code to drive conduct, by setting clear expectations of behaviour of the CEO and the rest of the organization. A strong code of ethics would also apply to incentive structures throughout the organization, and help assess whether they align with the mission.

According to the CFA Institute Corporate Governance Manual for Listed Companies, investors should determine whether the company has adopted a code of ethics and whether the company's actions indicate a commitment to an appropriate ethical framework.

Shortcomings in ethical conduct and poor incentive structures can lead to serious consequences. In 2018, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in Australia revealed that such issues in financial services firms led to unethical sales practices, which resulted in record fines. In response to the Commission's report, CFA Institute noted a recommendation of the Australian Government Productivity Commission that banks should appoint a principal integrity officer. The officer would report to the board of directors, to ensure their compliance with best interest duty. CFA Institute also suggested a more detailed, externally monitored assessment process.

Operation of the "comply and explain" is further elaborated in the last paragraph of page III-3 of the consultation paper and point 3 of page III-4. We agree with this principle-based implementation of the "comply or explain" regime. However, we trust that the issuers would find it helpful to have more guidance on what is considered reasonable in their circumstances.

Reference is also made to the proposed insertion of A.1.1 to Appendix 14 of the Listing Rules as shown on page III-11 of the consultation paper, in which it states that:

> *The board should establish the issuer's purpose, value and strategy, and satisfy itself that these and the issuer's culture are aligned. All directors must act with integrity, lead by example, and promote the desired culture. Such culture should instil and continually reinforce across the organisation of acting lawfully, ethically and responsibly.*

The wording of the proposed insertion looks fine but the question is how do we measure whether the directors had acted with integrity, led by example and promoted the desired culture? Perhaps, we can make reference to the UK CG Code, which requires the board to undertake an annual evaluation of its own performance. The evaluation would be based on skills, experience and independence of the directors, and their knowledge of the company. It would also evaluate how the board works together as a unit, and other factors relevant to its effectiveness. The evaluation must be externally assisted at least every three years and the evaluation must be disclosed annually.

The board evaluation requirement could first be introduced as an RBP. Subject to the result of subsequent reviews, the RBP could be upgraded to a CP later, if appropriate.

Question 2

Do you agree with our proposal to:

(a) introduce a CP requiring establishment of an anti-corruption policy; and

We agree.

Implementation an anti-corruption policy would help enhance anti-corruption awareness among the employees and the management of the issuers. In fact, Hong Kong is well known for its nearly corruption free business environment and the ICAC has been doing a good job on enforcement on corruption related cases. Nevertheless, issuers with centres of gravity of their business operations in jurisdictions where corruption is seemed to be an acceptable business practice may be tempted to follow local business norms and it is important that they have anti-corruption policy in place and comply with it. The Exchange may also wish to promote the anti-corruption education in joint force with the ICAC.

Despite the above, enforcement of the Listing Rules in Hong Kong does not have perfect legal backing. The implementation by the United States of the Foreign Corrupt Practices Act 1977 (FCPA) provides an example of an efficient enforcement of anti-corruption measures in foreign jurisdictions.

The FCPA is a US federal law that prohibits US citizens and entities from bribing foreign government officials to benefit their business interests. It is applicable worldwide and extends specifically to publicly traded companies and their personnel, including officers, directors, employees, and agents. Following the amendments made in 1998, the Act also applies to foreign firms and persons who, either directly or

through intermediaries, help facilitate or carry out corrupt payments on the US territory.

Pursuant to its anti-bribery purpose, the FCPA amends the Securities Exchange Act of 1934 to require all companies with securities listed in the US to meet certain accounting provisions, such as ensuring accurate and transparent financial records and maintaining internal accounting controls.

The FCPA is now jointly enforced by the Department of Justice and the Securities and Exchange Commission, which apply criminal and civil penalties, respectively.

In view of the above, the Exchange may consider working with other regulators and/or government bureaux on the legal backing of this CP.

(b) upgrade a RBP to CP requiring establishment of a whistleblowing policy?

We agree. Whistleblowing provides an important source of market intelligence to support enforcement actions by the SFC in Hong Kong. For instance, a whistleblower did play an important role in revealing the true picture of the Enron scandal in the US in 2000. Therefore, we support upgrading the RBP requiring establishment of a whistleblowing policy to CP. However, we are not aware of any employee protection for whistleblowers in Hong Kong. Without appropriate employee protection in place in Hong Kong, the implementation of the whistleblowing policy by the issuers may not be effective.

In the US, whistleblowing has been recognised and subject to protection at least since the Occupational Safety and Health Administration Act 1970. The Occupational Safety and Health Administration (OSHA) is the federal agency under the US Department of Labour that investigates and handles whistleblower complaints. Under the authority of the 1970 Act, OSHA operates a Whistleblower Protection Program that enforces more than twenty whistleblower statutes, including the Sarbanes-Oxley Act and the Dodd-Frank Act.

The Public Interest Disclosure Act 1998 (PIDA) constitutes the UK's whistleblowing legislation. It makes amendments to the Employment rights Act 1996 that protects employees who make a "qualifying disclosure" in the public interest. A CG issue will be covered by PIDA if it involves a failure to comply with a legal obligation to which the person is subject. Therefore, it will cover not only CG matters established under primary legislation, but potentially also many of the detailed CG requirements established by regulatory bodies, such as the Financial Reporting Council, that have statutory backing.

In view of the above, we consider that upgrading the RBP requiring establishment of a whistleblowing policy to CP is a good move. Nevertheless, more should be done on legislation to protect employees who make "qualifying disclosures" in the public interest.

Question 3

Do you agree with our proposal to introduce a CP requiring disclosure of a policy to ensure independent views and input are available to the board, and an annual review of the implementation and effectiveness of such policy?

We agree.

We consider that implementation of an efficient board evaluation mechanism would help ensure proper disclosure of information. Please also see our reply to Question 1

Question 4(a)

Do you agree with our proposal regarding re-election of Long Serving INEDs to revise an existing CP to require (i) independent shareholders' approval; and (ii) Additional Disclosure?[2]

We agree.

We would also like to make reference to the principle stated in B.1 of page III-12 of the consultation paper, which states that:

> *The board should have a balance of skills, experience and diversity of perspectives appropriate to the requirements of the issuer's business…….*

Setting a cap on the years of service of the INED is considered to be an efficient means for the boards to acquire new talents with the required skills, experience and diversity to serve the boards.

In Hong Kong, many issuers are dominated by controlling shareholders, which can be family groups, founding shareholders, or mainland Chinese parent companies, which could be

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The CFA Institute has the following additional comments to this question:

Public sector ownership of Hong Kong companies accounted for 38%, and that of other controlling shareholders (individuals and cross-holdings) accounted for a further 23%, according to OECD's 2019 study.

We have compared the experience of two markets, one with a very similar ownership structure (Malaysia), and other having dispersed ownership (Australia).

Like Hong Kong, Malaysia has also faced issues with long-tenured directors. In its 2017 revision of the CG code, Malaysia introduced a two-tier approval (majority and majority-of-minority) for appointments of long-tenured directors (over 12 years). To analyse the rule's effects, in 2020 the Securities Commission Malaysia conducted a study of shareholder resolutions relating to independent directors' tenure. It found that 98% of the 268 such two-tier resolutions were voted in favour, with barely over half the votes cast. Subsequently, in April 2021, Bursa Malaysia proposed a hard tenure limit of 12 years, after soliciting feedback from issuers and the market.

While we do not wish to draw conclusions from the experience of one market, we believe that directors with long tenures are not independent, regardless of shareholder approval. Companies have the option of redesignating valuable long-tenured directors as non-independent. Therefore, a hard tenure limit may be considered as one option.

Australia, on the other hand, has a more dispersed ownership structure, with institutions and free float accounting for 89% of ownership in listed companies, according to the aforementioned OECD study.

state owned enterprises. Therefore, public shareholders have less influence on the issuers' governance compared to those in markets such as Australia. In fact, it is not uncommon for the issuers to have INED with tenure of more than nine years.

There could be a relationship between the ownership structure and the duration of the INED appointment.

In addition, board directors in Australian companies are appointed for a period of three years, and each year, one-third of the directors must stand for re-election. Although this process does not help avoid board entrenchment, the risk is mitigated by shareholders' ability to remove board members without cause by calling an extraordinary general meeting.

It is revealed in the CFA Institute's study on independent directors in Asia Pacific to be published that despite there not being a hard cap on the tenure limit for INEDs in Australia, the average tenure of directors in companies is roughly seven years. Approximately 70% of the directors have been on the board between four and nine years, and less than 20% of the directors serve the boards for more than 9 years. [3]

In view that long serving INEDs may not be perceived as independent, special rules are applied to long serving directors in some major capital markets. Under the UK CG code, the re-appointment should be subject to rigorous review after six years of service; and after nine years, the director would be subject to annual review. Whereas Mainland China has a more rigid regime requiring INEDs not to hold the positions for more than six consecutive years.

Board entrenchment is clearly an issue with a few Hong Kong companies. For example, more than half of the INEDs on the board of New World Development in November 2020 had a tenure of more than nine years. Among the long serving INEDs for New World Development, Mr Yeung Ping-Leung, Howard had been serving on the board for 21 years as at November 2020.

The proposal could be regarded as a reminder to the issuers to refresh the composition of the board.

Question 4(b)

Do you agree with our proposal to introduce a CP requiring an issuer to appoint a new INED at the forthcoming AGM where all the INEDs on the board are Long Serving INEDs, and disclosing the length of tenure of the Long Serving INEDs on the board on a named basis in the shareholders' circular?

We agree.

When the INEDs of the board are long-serving directors, the proposed appointment of a new INED to the board effectively pushes the issuer to undergo limited board refreshment. However, given that it is common that issuers in Hong Kong are dominated by controlling shareholders, the extent of influence the new INED could exert on the board is questionable. Therefore, it is important to put in place the board evaluation mechanism mentioned in our reply to Question 1 to ensure that the operation of the board is efficient.

Question 5

Do you agree with our proposal to introduce a new RBP that an issuer generally should not grant equity-based remuneration (e.g. share options or grants) with performance-related

[3] Source: Factset. Based on companies with at least US$500 mn market cap as of August 2020.

elements to INEDs as this may lead to bias in their decision-making and compromise their objectivity and independence?

We agree

It is important that the INEDs remain independent. An NED who holds more than a 10% stake in the issuer would in general not be considered independent. The Australian CG code defines director independence very precisely as "freedom of conflicts of interest that might influence ability to exercise independent judgement and act in the interest of shareholders".

When the INEDs are remunerated with equity-based remuneration, there are conflicts of interest and the INEDs could hardly satisfy the Australian CG code definition.

Besides, as per paragraph 78 of the consultation paper, the UK requires, on a comply or explain basis, that remuneration for all non-executive directors should not include share options or other performance-related elements, while Australia recommends that issuers' NEDs do not receive performance-based remuneration as this may compromise their objectivity.

Despite the above, the remuneration committees of the issuers should ensure that the remunerations of the INEDs are competitive for recruiting candidates of the right calibres.

Question 6(a)

Do you agree with our proposal to highlight that diversity is not considered to be achieved by a single gender board in the note of the Rule?

We agree.

We believe that gender diversity is a key element for board diversity. However, factors contributing to diversity include gender, age, cultural background, educational background, and professional experience. Diversity of perspectives is important for the quality of decision making in issuers' boards. A good diversity policy would help improve effectiveness and lessen the risk of groupthink in the board decision making process.

Issuers should find it difficult to claim that their single gender board can satisfy the principle stated in B.1 of page III-12 of the consultation paper in which it states that:

> *The board should have a balance of skills, experience and diversity of perspectives appropriate to the requirements of the issuer's business……*

Question 6(b)

Do you agree with our proposal to introduce a MDR requiring all listed issuers to set and disclose numerical targets and timelines for achieving gender diversity at both: (a) board level; and (b) across the workforce (including senior management)?

We agree. This would serve as a catalyst for the issuer to adopt a gender diversity policy

Question 6(c)

Do you agree with our proposal to introduce a CP requiring the board to review the implementation and effectiveness of its board diversity policy annually?

We agree.

The requirement can actually be included in the board evaluation mechanism mentioned in our reply to Question 1.

Question 6(d)

Do you agree with our proposal to amend the relevant forms to include directors' gender information?

We agree.

This proposal promotes information transparency.

Question 7

Do you agree with our proposal to upgrade a CP to Rule requiring issuers to establish a NC chaired by an INED and comprising a majority of INEDs?

We agree.

We consider the justifications for implementing this proposal had been duly summarized in paragraphs 92 & 93 of the consultation paper which are reproduced below:

> *Given the importance of the role directors play on the governance of the company, appointments to the board should be subject to a formal, rigorous and transparent process. The NC serves as an independent oversight of matters relating to board nomination and recruitment and diversity, as well as planning for succession. It is crucial to have development plans for current board members and progression plans for those looking to move to the board level.*
>
> *We note that US requires a NC to comprise entirely of INEDs, while Australia, Singapore and the UK require an issuer, on a "comply or explain", to establish a NC with a majority of INEDs.*

We also support the suggestion in paragraph 94 of the consultation paper that:

> *….expected disclosures regarding INED nomination and appointment, including the channels used in searching for appropriate INED candidates (whether through search firms, advertisements or personal network), and the potential contribution the candidates would bring to the board (in terms of their qualifications, skills and experience).*

We trust the above proposal would promote transparency on the nomination and appointment of the INEDs that can help the investors to make informed decisions.

Question 8

Do you agree with our proposal to upgrade a CP to a MDR to require disclosure of the issuer's shareholders communication policy (which includes channels for shareholders to communicate their views on various matters affecting issuers, as well as steps taken to solicit and understand the views of shareholders and stakeholders) and annual review of such policy to ensure its effectiveness?

We agree.

This proposal would promote transparency of the communication policy and help manage investors' expectations.

Question 9

Do you agree with our proposal to introduce a Rule requiring disclosure of directors' attendance in the poll results announcements?

We agree that director attendance is an important piece of information.

Directors' attendance at general meetings is one of the good indicators on whether the directors are committed to discharge their fiduciary duties to the shareholders. However, this information should be made available to shareholders prior to general meetings, in addition to poll results announcements, so that they could vote in an informed manner.

Question 10

Do you agree with our proposal to delete the CP that requires issuers to appoint NEDs for a specific term?

We agree.

Deleting of the said CP seems to be in line with the trends in UK, Singapore and Australia that NED appointments are subject to periodic review when considering re-election.

Question 11

Do you agree with our proposal to elaborate the linkage in the Code by (a) setting out the relationship between CG and ESG in the introductory section; and (b) including ESG risks in the context of risk management under the Code?

We agree.

Investors are increasingly aware that the ESG issues could impact the issuers' access to capital, cost of capital, the likely environmental and social risks that the issuers may face, and the way they manage these risks. There is clear linkage between CG and ESG. In addition, climate change-related impacts present financial risks to many, if not all sectors, in which the issuers operate. Therefore, we support including ESG risks in the context of risk management under the code.

Question 12

Do you agree with our proposal to amend the Rules and the ESG Guide to require publication of ESG reports at the same time as publication of annual reports?

We agree in principle. However, issuers, big and small, may need time to transition to the new timeline for preparing the ESG reports.

We observe that the standards of the ESG reports prepared by the issuers do vary. ESG reports prepared by larger issuers could be very comprehensive and at an elevated standard. However, some issuers who are less serious about the ESG reports may just prepare their reports based on boilerplate. The Exchange should consider implementing measures to help those issuers who wish to improve the quality of their ESG reports.

It is also important that the larger issuers should not compromise the quality of their ESG reports because they need to rush to complete their ESG reports together with the annual reports at the same time. Therefore, there should be sufficient transition period for the implementation of this new requirement.

Question 13

Do you have any comments on how the re-arranged Code is drafted in the form set out in Appendices III and IV to this paper and whether it will give rise to any ambiguities or unintended consequences?

No further comment.

Question 14

In addition to the topics mentioned in this paper, do you have any comments regarding what to be included in the CG GL which may be helpful to issuers for achieving the Principles set out in the Code?

No further comment.

Question 15

Do you agree with our proposed implementation dates of:

(a) for all proposals (except the proposals on Long Serving INED): financial year commencing on or after 1 January 2022; and

(b) for proposals on Long Serving INED: financial year commencing on or after 1 January 2023?

We agree in principle. Yet, larger issuers which completed their ESG reports at an elevated standard may need more time to comply with the new deadline instead of compromising the quality of their ESG reports in a rush. Please also refer to our reply to Question 12.

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[i] In preparing the responses, we had made reference to Report on Improving Corporate Governance in Hong Kong – A comparative-based study by Syren Johnstone and Say H Goo published by HKICPA on 15 December 2017. Some texts in the country reports of the study had been extracted and reproduced in the above responses.