



Deloitte China Independent Non-Executive Director Series
Workshop #26 - Review and Analysis of Proposed Amendments to the Corporate Governance Code and Related Listing Rules (November 2017)

Hugh Gozzard, Partner
Risk Advisory, Hong Kong
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Agenda

Hong Kong Stock Exchange's ("HKSE") proposed amendments to the Corporate Governance Code and related Listing Rules:

PART I: INDEPENDENT NON-EXECUTIVE DIRECTORS ("INED")

1. Over-boarding and INED's time commitment
2. Board diversity
3. Factors affecting INED's independence:
 - A. Cooling off periods for former professional advisers
 - B. Cooling off period in respect of material interests in business activities
 - C. Cross-directorships or Significant Links with other Directors
 - D. Family ties

PART II: NOMINATION POLICY

PART III: DIRECTORS' ATTENDANCE AT MEETINGS

1. Directors' attendance at general meetings
2. Chairman's annual meetings with INEDs

PART IV: DIVIDEND POLICY

PART V: ELECTRONIC DISSEMINATION OF CORPORATE COMMUNICATIONS – IMPLIED CONSENT

Part I - Independent Non-Executive Directors (1)

Overboarding and INED's time commitment

In circulars to shareholders regarding resolutions to elect INEDs, issuer should, where the new INED already holds six or more directorships, explain why the INED would be able to devote sufficient time to the issuer's board (revision to the current CP A.5.5).

Discussion

- To address market concerns that INEDs often do not devote sufficient time to their issuers.
- Aims to enable shareholders to make better informed voting decisions at general meetings.
- Mechanical numerical threshold to address a wide range of different circumstances.
- **Issuers should review their strategies and processes for INED nomination, and should examine whether any of their existing INEDs do have any time commitments issues.**
- **INEDs should question themselves on the appropriateness of the number of positions they currently hold.**

Part I - Independent Non-Executive Directors (2)

Board diversity

Upgrade current Code Provision (“CP”) (A.5.6) to a Listing Rule (“LR”) (13.92) so that an issuer is required to establish a diversity policy and to disclose this (or a summary thereof) in its corporate governance report.

Relevant amendments to the Mandatory Disclosure Requirements to reflect this upgrade (i.e. including requiring disclosure of any measurable objectives for implementing the policy and of the progress regarding the achievement of these objectives).

Amendments to CP A.5.5 - circulars to shareholders regarding resolutions to elect an INED should set out processes for identifying the INED, the perspectives, skills and experience the INED is expected to bring and how the INED will contribute to the board’s diversity.

Discussion

- Concerns that Hong Kong lags behind other markets on gender diversity, with change only taking place slowly. Disclosure requirements in Hong Kong are also more limited. To encourage issuers to re-consider and justify their approaches to diversity.
- CP on measurable objectives and related progress should arguably be made an LR to help ensure implementation of issuers’ diversity policies.
- **Issuers should increase their focus on all forms of board diversity – as a source of value as well as simply to achieve compliance.**

Part I - Independent Non-Executive Directors (3)

Cooling-off periods for former professional advisors and auditors

- Extend the cooling-off period from one to three years for a prospective INED who has been a director, partner, principal or an employee of a professional adviser to the issuer (as well as its group, controlling shareholders, etc.) (LR 3.13(3)).
- Extend the cooling-off period from one to three years for former partners of the issuer's audit firm who will act as audit committee members (CP C.3.2).

Discussion

- Aiming to align this aspect of INED independence more closely to the longer cooling off periods of other major markets.
- Consistent approach (LR v CP)?
- **Both issuers and prospective INEDs need to examine the facts relating to each potential appointment, and their implications for independence, more carefully.**

Part I - Independent Non-Executive Directors (4)

Cooling off period in respect of material interests in business activities

Revise the LR 3.13(4) to introduce a one-year cooling off period for a prospective INED who has had material interests in the issuer's principal business activities in the past year.

The proposal does not alter the concept of material interests which is in the current Rule but it takes into account such interests for one year before the proposed appointment of the INED.

Discussion

- Aiming to achieve better alignment with international practice, which generally requires this cooling off period, and in order to improve levels of INED independence (and perceptions thereof).
- **Again, both issuers and prospective INEDs need to examine the facts relating to each potential appointment, and their implications for independence, more carefully.**

Part I - Independent Non-Executive Directors (5)

Cross-directorships or significant links with other directors

New recommended best practice disclosure in the corporate governance report (A.3.3) of an INED's cross-directorships (i.e. where two or more directors sit on each other's boards) or significant links to other directors (i.e. through involvements in other companies or bodies) through involvements in other companies or bodies.

Discussion

- Cross-directorships or significant links with other directors are seen as potentially undermining INED independence.
- Case for making this disclosure requirement a CP (or even LR) to promote consistency of the information provided by issuers and to help ensure that it's followed in practice?
- Relevant to all directors (rather than just INEDs)?
- **Again, both issuers and prospective INEDs need to examine the independence implications of each intended appointment more carefully, performing detailed due diligence in each case.**
- **Issuers should review their existing practices for making related party declarations and make any necessary changes to this, with which INEDs will need to comply.**

Part I - Independent Non-Executive Directors (6)

Family ties

Introduce a Note under LR 3.13 to encourage inclusion of an INED's immediate family members in the assessment of the INEDs independence, adopting the same definition of "immediate family member" as in LR 14 A.12(1)(a) i.e. *"spouse, his (or his spouse's) child or step-child, natural or adopted, under the age of 18 years"*.

Discussion

- An INED's independence may be affected by the INED's immediate family members' connections with the issuer but this is not currently an independence consideration.
- Should the definition also cover children that are over 18 years of age?
- **Again, a further independence factor for issuers and INEDs to consider.**
- **Related party declarations procedures should be updated to accommodate the amendment, with which INEDs will need to comply.**

Part II - Nomination policy (2)

Nomination policy

Amending Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 to state that the issuer should disclose the nomination policy it adopts during the year.

The policy should set out the board's consideration of CP A.3, i.e. how the policy enables the board to achieve having a balance of skills, experience and diversity of perspectives appropriate to the requirements of the issuer's business.

Discussion

- Aiming to promote transparency with respect to the issuer's nomination policy as a means of achieving board diversity. Focuses on the end result and explicit policy document, as opposed to mere process.
- **Requires issuers to reconsider the effectiveness of their current nomination policies in terms of their ability to achieve greater board diversity, and to upgrade them where necessary.**

Part III – Directors’ attendance at general meetings (1)

Directors’ attendance at general meetings

Amend CP A.6.7 by removing the last sentence of the current wording, i.e.:

“[INEDs] should.....attend general meetings and develop a balanced understanding of the views of shareholders.”

Discussion

- The HKSE believes that strict interpretation of the sentence means that any directors’ absence from a general meeting would represent a deviation from the CP, which is not its intention. Interpretation of CP A.6.7 is currently inconsistent amongst issuers in this respect.
- However, would deleting the sentence give the impression that attendance by directors at the AGM is not important (i.e. the existing CP supports the principle of this attendance)?

Part III – Directors' attendance at general meetings (2)

Chairman's annual meetings with INEDs

Revise CP A.2.7 to state that the chairman should meet with the INEDs, without the executive directors being present, at least annually, even if the chairman is not an INED.

Discussion

- Under the current CP A.2.7, the chairman should hold meetings at least annually with the non-executive directors (including INEDs) without the executive directors being present, acting as a check on executive directors and management. However, this check is not effective when the roles of chairman and chief executive are performed by the same person.
- Yet the proposed change ensures that the chairman meets with the INEDs, even in the cases when the chairman is not an INED, as this is still perceived as being by the HKSE as being of value.
- **Issuers will need to incorporate the requirement for this meeting into their board practices.**

Part IV – Dividend policy (1)

Dividend policy

Introducing a new CP (E.1.5) requiring issuers to disclose their dividend policies in their annual reports.

Discussion

- The HKSE holds the view that a dividend policy is critical in helping potential investors to assess the “character” of the management of an issuer (i.e. capital discipline and attitude to minority shareholders) and therefore that disclosure of such policy would allow investors to make more informed investment decisions.
- Disclosure brings Hong Kong in line with US and UK.
- Few issuers currently disclose dividend policies.
- **Issuers will need to formulate dividend policies, making sure these are realistic and achievable and also consider the potential adverse impacts of not being able to fulfill any such policy.**

Part V - Electronic dissemination of corporate communications

Electronic dissemination of corporate communications – implied consent

Amend current LRs to allow shareholders' consent for electronic dissemination of corporate communications by issuers to be implied (*the HKSE is simply seeking views on this point, without currently proposing to implement this change*).

Discussion

- The amendment would require shareholders to opt in specifically and explicitly in order to receive hard copy communications.
- Would only apply to issuers which have articles of association that do not contradict the new requirement i.e. which state that shareholders shall receive corporate communications via electronic means (without providing an automatic right to receive hard copies). Hong Kong company law does not permit implied consent.
- Driven by environmental concerns.
- Other alternative or variant approaches:
 - Shareholders receive a one-off hard-copy notice of the opt-in arrangement for return by post (with the issuer's return envelope).
 - Issuers to state on their websites that they have adopted electronic dissemination with contact details for shareholders to provide an opt-in notice at any time.
 - Allowing issuers to send hard copy notifications only to those shareholders that have not provided an e-mail address to the issuer.

Summary (1)

Your next steps

Issuers

- Review and enhance policy documents and practices for diversity, nomination and dividends.
- Increase focus on INED independence (both on selection and ongoing) and incorporate the new requirements into existing policies & procedures.
- Make diversity a strategic concern.
- Review current practices for board evaluation (collective and individual) and enhance these as needed.

INEDs

- Pay more attention to stricter independence requirements (when seeking new positions and in relation to current ones).
- Focus on time commitment.

Thank you

Q&A



Contact

Partner, Risk Advisory, Deloitte Hong Kong



Hugh Gozzard

Tel: +852 2852 5662

Fax: +852 2541 7392

Email: huggozzard@deloitte.com.hk

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