

Independent Audit Limited Response to Hong Kong Exchanges and Clearing Limited (HKEx) Consultation Paper on Corporate Governance

On 14 June 2024, The Stock Exchange of Hong Kong Limited (the Exchange), part of HKEx, released a [Consultation Paper](#) on Review of Corporate Governance Code (CGC) and related listing rules. We're pleased to share Independent Audit Limited's (IAL) response.

The consultation follows on from the amendments to the CGC that came into effect on 1 January 2022. In developing the present proposals, the Exchange has drawn from regulatory developments in jurisdictions including the UK, Australia, Singapore, Malaysia and Mainland China.

The consultation period ends on 16 August 2024 with an ambitious implementation date, subject to market feedback, of 1 January 2025, with a 3-year transitional period.

Here we share IAL's response to the key points of consultation paper.

Our key points include:

- 1. Independent Lead INED:** We support introducing a Code Provision requiring issuers without an independent board chair to appoint a Lead INED. This enhances investor and shareholder engagement, ensuring robust independent oversight.
- 2. Continuous Professional Development (CPD):** While we agree that continuous professional development should be mandatory, we agree with HKEx that a minimum number of hours should not be specified as doing so means the training may lack flexibility. A tailored approach based on individual and organisational needs is preferred.

With regard to specifying the topics for CPD we believe that doing so is overly prescriptive and training depends on the company. Each should, together with their directors, be determining what is required in order to enable directors to meet their legal duties and add value in their role.

- 3. First-Time Directors:** We do not agree with the proposal to define "first-time directors" as proposed by HKEx as it is important not to be overly prescriptive in the Code.
- 4. Regular Board Performance Reviews:** While we welcome the proposal to introduce mandatory board performance reviews, we do not agree with the proposal to upgrade the current Recommended Best Practice (RBP) in the CG Code to a Code Provision requiring issuers to conduct regular board performance reviews at least every two years and make disclosure as set out in CP B.1.4. as we believe that this is insufficient. A formal review should be required annually as changes in the board, the way the board works, and the company's circumstances may alter considerably during the course of the year.

Also, a periodic, independent external review should be a requirement, or non-compliance explained. Experience in the UK and other countries has shown that this approach is needed in order to make sure that all companies take the requirement seriously. Simply relying on an internal review is insufficient as potentially a significant number of companies may not take a sufficiently rigorous approach and instead opt for box ticking.

5. **Skills Matrix:** While the requirement to maintain a skills matrix and the requirement to explain how the combination serves the issuer's needs are both sound, we disagree with the proposal as, in our opinion, it is unrealistic to require detailed explanation of what the board is looking to acquire and related plans as making changes may require a number of years. Also, there may be commercial and individual sensitivities that need to be recognised.
6. **Introduction of a 'hard cap' of six directorships:** We agree with the proposal to limit the number of listed company directorships a person can hold to six. We believe that a director position on a listed company board requires the dedication of a significant amount of time. Typically, this is in the region of 30-40 days a year. Some exceptions may be needed in the case of directorship of asset management / funds given the nature of their activity. The transition period of three years, as proposed by the Exchange, is reasonable.
7. **Mandatory Disclosure Requirement (MDR) of time commitment and contribution of directors to the Board:** We disagree with this proposal as we believe that such disclosure should be internal to the board. There may be numerous mitigating circumstances that should not be disclosed publicly - e.g., illness. Also, any such assessment may be subjective. Furthermore, any public disclosure could provoke an unhelpful reaction. Based on our experience we believe that it is up to the Chair and the Nomination Committee to manage any such issues in real time.
8. **'Hard Cap' of nine years for tenure of INEDs after which the director will not be considered independent:** We agree with this proposal. Experience in the UK and elsewhere has shown that this is important in securing renewal and refreshing of the board and also enabling better diversity. Furthermore, it gives the Chair and the Nomination Committee an opportunity to refresh the Board and to remove any non-performing directors without it becoming a point of dispute or contention.

With regard to the proposal to consider a director as independent by the same issuer after an absence of two years, having previously served nine years as an INED, we disagree with the proposal as this is an insufficient period to ensure that the director is detached from the company, previous decisions and, most importantly, from the executive team. We agree with the proposed three-year transition period as time is required to implement this without causing unhelpful disruption. Also, the changes need to be introduced over time so that the Board does not face the need for wholesale changes in nine years' time.

9. **Requirement for all issuers to disclose the length of tenure of each director in the CG Report:** We agree with this proposal. It is important that stakeholders have this information given the importance of length of tenure.
10. **Requirement to have at least one director of a different gender on the Nomination Committee:** We agree with this proposal. It is important to have a voice promoting gender diversity on the board and in the company. Also, evidence indicates that diversity in discussion and in opinions is promoted by having diversity in the committee itself. It is important to make this a requirement in order to ensure that such changes happen.

We also agree with the proposal for listed companies to have and disclose a diversity policy for their workforce as this is an effective method in bringing the necessary focus. This is also true of the proposal to introduce an MDR on the annual review of the implementation of a company's board diversity policy.

- 11. Annual reviews of the effectiveness of risk management and internal control systems:** We agree with this proposal as we believe that this will help ensure that audit committees and boards take a suitably structured and rigorous approach to assessing effectiveness, including requiring evidence.
- 12. Dividend Policy Disclosure:** We do not agree with this proposal. While transparency is crucial, expecting issuers to disclose underlying reasons for dividend decisions may be unrealistic. Policy disclosure should be sufficient.
- 13. Record Date for Voting Eligibility:** We agree with this proposal to set a record date to determine security holders eligible for voting and entitlements, promoting clarity and fairness.
- 14. Modified Auditors' Opinions Disclosure:** We agree with this proposal. Codifying disclosures related to modified auditors' opinions into the Listing Rules is essential for maintaining transparency and trust.
- 15. Monthly Updates to directors:** We agree with this proposal. Providing monthly updates that give a balanced and understandable assessment of the company's performance, position and prospects should be a standard practice to enable directors to fulfill their duties effectively. It is unclear, however, why this should be addressed in the Code when each board should recognise the benefit of keeping their directors well-informed; it appears to be overly prescriptive.
- 16. Nominations Committee Independence:** We agree with this proposal. Ensuring a strong, independent presence in the Nominations Committee is vital for consistent governance practices.
- 17. Implementation Date:** We do not agree with the proposed implementation date. We believe the proposed start date of January 2025 is overly ambitious. It may cause unnecessary pressure in the NED market. Also, it risks companies slipping into superficial compliance rather than allowing time to ensure that the changes are well-embedded. A more phased approach would be prudent.

*#CorporateGovernance #HKEx #IndependentAudit #IAL #BoardLeadership #GovernanceStandards
#InvestorEngagement #Transparency*

Feel free to contact us for any queries or further discussions to help you increase your board's effectiveness.

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