

HKEX Proposes Listing Rules Changes on Independent Non-Executive Directors and Others

The Stock Exchange of Hong Kong Limited (the “Exchange”) recently published two consultation papers proposing changes to:

- the Corporate Governance Code (the “Code”) and Corporate Governance Report as well as related amendments to its Listing Rules; and
- documentary requirements relating to listed issuers and other minor Rule amendments.

As the title suggests, the Exchange’s proposals covered diverse areas ranging from corporate governance, documentary requirements relating to structured products, to house keeping amendments. In this article, we concentrate on proposals relating to directors and board committees only, which, for the purpose of simplicity, are presented in tabulated form and reference is made to the Main Board Listing Rules (the “Rules”).

Non-Executive Directors (INEDs)—Independence Criteria

Rule 3.13 sets out a detailed but non-exhaustive list of factors that the Exchange takes into account when assessing the independence of INEDs. No additional factors but amendment to strengthen the criteria are proposed.

	PROPOSED CHANGES	REASONS FOR CHANGES
Rule 3.13(3)	Extend the cooling off period for a proposed INED who has been a director, partner, principal or an employee of a professional adviser providing services to the issuer and related entities from one year to three years.	To align with international practice (current cooling off period under the Rules is shorter than the majority of overseas jurisdictions reviewed).
Rule 3.13(4)	Introduce a one-year cooling off period for a proposed INED who has had material interests in the issuer’s principal business activities in the past.	To align with international practice (a cooling off period of one to three years is imposed in the majority of overseas jurisdictions reviewed).
Note to Rule 3.13	Introduce a new note to encourage inclusion of an INED’s immediate family members’ connection with the issuer in the assessment of their independence.	To align with international practice (family ties is a consideration factor in the majority of overseas jurisdictions reviewed).
RBP A.3.3	Introduce a new Recommended Best Practice (RBP) (i.e., subject to voluntary disclosure) that the board should state its reasons in the Corporate Governance Report if it determines that a director is independent notwithstanding that he holds cross-directorships or has significant links with other directors through involvement in other companies or bodies.	To improve transparency of INED’s relationship with the issuer (Hong Kong Monetary Authority’s Guidance on the Empowerment of INEDs in Banking Industry in Hong Kong includes cross-directorship as a considering factor).

	PROPOSED CHANGES	REASONS FOR CHANGES
Code Provision C.3.2	Extend the cooling off period for former partners of the issuer's audit firm to act as a member of the issuer's audit committee from one to three years.	To align the proposed change to Rule 3.13(3) mentioned above.

Over-boarding and INED's Time Commitment

No cap on multiple directorship but the board must explain if an INED holds seven or more.

	PROPOSED CHANGES	REASONS FOR CHANGES
Code Provision A.5.5	If the nominee will be holding his seventh (or more) listed company directorship, the circular to shareholders accompanying the election resolution should give reasons for determining that the proposed INED would be able to devote sufficient time to the board.	To address market concern - the Institutional Shareholder Services, Inc.'s <i>2016 Benchmark Policy Recommendations for Hong Kong</i> 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.
New Guidance	Guidance setting out some considerations in assessing whether an INED nominee may be over-boarded.	As above.

Board Diversity

Diversity policy is upgraded from a Code Provision (i.e., subject to 'comply or explain') to become a Rule requirement.

	PROPOSED CHANGES	REASONS FOR CHANGES
Rule 13.92; Mandatory Disclosure Requirement L. (d) (ii)	Upgrade Code Provision 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.	Numerous research and studies indicate that board diversity enhance corporate governance and is increasingly a factor for investors making investment decision.
Code Provision A.5.5	The circular to shareholders accompanying the election resolution should in addition set out how the proposed INED would contribute to diversity of the board.	As above.

Other Changes Relating to INEDs

	PROPOSED CHANGES	REASONS FOR CHANGES
Code Provision A.2.7	Revise A.2.7 to state that INEDs (excluding NEDs) should meet at least annually with the chairman.	To serve as a more effective check on management.
New Guidance	Guidance encouraging INEDs to be appointed at least two months prior to listing.	To give INEDs sufficient time to gain a proper understanding of the listing applicant's affairs, and their responsibilities as directors of a listed company before listing.

	PROPOSED CHANGES	REASONS FOR CHANGES
Code Provision A.5.5	<p>Revise A.5.5 so that information contained in the board's circular to shareholders accompanying the election resolution should include:</p> <ol style="list-style-type: none"> the process used for identifying the proposed INED and why the board believes he should be elected and the reasons why they consider him to be independent; if the proposed INED will be holding his seventh (or more) listed company directorship, why the board believes the person would still be able to devote sufficient time to the board; the perspectives, skills and experience that he can bring to the board; and how he contributes to diversity of the board. 	<p>To enhance transparency of the nomination and election of INEDs.</p> <p>Consequential changes as a result of the proposals relating to Over-boarding and INED's time commitment (A.5.5 (b)) and Board diversity (A.5.5(d)).</p>

Removal of the Directors' Declaration and Undertaking (the Form B, Form H and Form I, Together the "DU Forms") and Consequential Changes

	PROPOSED CHANGES	REASONS FOR CHANGES
DU Forms	Remove the requirement of filing DU Forms.	Current filing requirement is administratively cumbersome for issuers and their directors/supervisors.
Rule 3.09A-3.09D, Rule 3.20B	The directors' and supervisors' obligations currently set out in Part 2 of the DU Forms to be incorporated into the Rules.	Consequential changes as a result of removing the DU Forms - directors and supervisors continue to be subject to the same requirements.
Rule 3.20, Rule 13.77	Directors and supervisors would be required to submit their personal information and contact details, and any changes to such information to the Exchange using a new form. In addition to residential addresses as required under the DU Forms, contact details including telephone numbers, mobile phone numbers, facsimile numbers, email addresses and correspondence addresses are required.	<p>Consequential changes as a result of removing the DU Forms.</p> <p>Additional requirement to make clear what contact details should be submitted to the Exchange.</p>
Rule 13.51	Disclosure of the former name and alias (if any) of a director or supervisor in the appointment announcement or in an IPO case, the listing document.	Former name and alias is currently information submitted to the Exchange under the DU Form.

Dividend Policy be disclosed in the Annual Report

	PROPOSED CHANGES	REASONS FOR CHANGES
Code Provision E.1.5	Introduce a new Code Provision that the issuer should have a policy on payment of dividends and should disclose it in the annual report.	To allow investors to make a more informed decision when investing in a listed company (disclosure of dividend policy is required in most overseas jurisdictions reviewed).

Nomination Policy be disclosed in the Corporate Governance Report

Mandatory Disclosure Requirements (MDR) L.(d)(ii) of Appendix 14 currently requires disclosure of the summary of work performed by the nomination committee during the year in the Corporate Governance Report. It is now proposed that the policy itself should be disclosed.

	PROPOSED CHANGES	REASONS FOR CHANGES
MDR L.(d)(ii)	Revise to state that the issuer should disclose its nomination policy adopted during the year. The policy should set out the board's consideration of Code Principle A.3, i.e., the board should have a balance of skills, experience and diversity of perspectives appropriate to the requirement of the issuer's business.	To promote transparency on the issuer's nomination policy and process that would enable the issuer to achieve the balance of skills, experience and diversity on boards.

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