

# SEHK's Proposal to Reform the Independent Directors Regime and Strengthen the Corporate Governance of Listed Companies

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## SEHK's Proposed Amendments to the Corporate Governance and INED Regimes in Hong Kong

Further to the introduction by the Stock Exchange of Hong Kong Limited (SEHK) of significant changes to the Listing Rules and related provisions regarding the risk management and internal control of listed companies, in November 2017, SEHK issued a consultation paper on corporate governance matters, seeking to further strengthen the internal governance of listing companies and reform the requirements regarding independent non-executive directors (INEDs).

### Spotlight on the independence of INEDs

The consultation is divided into several aspects, including concerns about INEDs being employed by more than six listed companies; improving the standards for INEDs; board diversity; and disclosure of dividend policy; and proposed amendments on other governance matters.

- (1) Code Provision: explain if an INED is employed by more than six listed companies

According to the current requirements, there must be at least three INEDs on the board of directors of a listed company. Furthermore, 1/3 of the board of directors must be INEDs. Generally speaking, INEDs are persons with expertise that is external to the company, including auditors, lawyers, and other professionals. INEDs must be able to provide independent advice on the listed company's business decisions, protect the interests of the shareholders, particularly those of minority shareholders, and prevent occurrences of conflicts of interests.

In order to perform their duties, all directors of listed companies should ensure sufficient time and effort to fulfill their obligations. However, in practice, some INEDs may not be able to properly allocate their time and energy to perform their duties properly due to their positions in a large number of listed companies. In the consultation paper, SEHK recommends that if INEDs are employed in more than six listed companies, the listed companies are required to explain whether they have sufficient time to perform their duties. This is a reasonable proposal, as directors are required to attend meetings of the board of directors and committees, review transactions and supervise the company. If an INED is involved with too many listed companies, the INED will be unable to allocate his time and energy reasonably. Some INEDs are unable to attend meetings of the boards of directors of listed companies due to time conflicts, and are unable to participate in the independent supervision of the companies. In practice, other jurisdictions also have restrictions on the involvement of INEDs in multiple listed companies. For example, mainland China stipulates that a person can only hold five INED positions to ensure that they have enough time to perform their duties.

- (2) Enhancing the independence of INEDs

The suggestions on improving the independence of INEDs include (i) extending the cooling off period for former professional advisers of the issuer from one year to three years; (ii) introducing 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 year; and (iii) inclusion of an INED's immediate family members' connection with the issuer in the assessment of their independence. These suggestions are feasible and reasonable. Given the fact

that listed companies rely on INEDs for independent advice, it is necessary to raise the standards for independence to ensure that they can make fair judgments without any conflicts of interest.

### (3) Strengthening the diversity of board members

According to Code Provision (“CP”) A.5.6, the nomination committee should have a policy concerning diversity of board members, and should disclose the policy in the Corporate Governance Report. Diversity of board members can be achieved through consideration of gender, age, cultural and educational background, or professional experience. SEHK data show that in 2013, after the introduction of CP A.5.6, the proportion of women in Hong Kong listed companies’ boards of directors increased from 10.3% in May 2012 to 12.2% in 2016, indicating a slight improvement. SEHK hopes to promote effective decision-making and improve corporate governance through enhancing the diversity of board members and encouraging the greater variety of gender and experience in the hiring of directors. To encourage issuers to consider and explain their considerations in relation to diversity, SEHK proposes to upgrade CP A.5.6 to a listing rule requiring issuers to have a diversity policy and to disclose the policy in the issuer’s corporate governance reports to improve performance and transparency. This is a good suggestion; given that

Hong Kong is an international financial center, the boards of directors of listed companies should be encouraged to honor board diversity and play a leading role in this area.

### (4) Disclosure of dividend policy

SEHK proposes to introduce CP E.1.5 requiring the issuer to disclose its dividend policy in the annual report. The disclosure of dividend policy would allow investors to make a more informed decision when investing in a public listed company.

### Conclusion

The consultation paper puts forward many constructive suggestions from a practical point of view, which can help the boards of directors of Hong Kong listed companies to enhance their corporate governance. Among the board of directors, INEDs play an important role in the corporate governance of Hong Kong listed companies. The amendments regarding INEDs can enhance the standards of corporate governance of listed companies. Through these revisions, the listed companies in Hong Kong will pay closer attention to the role of INEDs in their corporate governance and promote, by way of nomination and appointment of suitable, independent and qualified INEDs to the boards of directors and enable them to play active roles.

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