



Hong Kong

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## HKEX PROPOSES TO REVISE CORPORATE GOVERNANCE CODE AND RELATED LISTING RULES

On 16 April 2021, the Stock Exchange of Hong Kong Limited (“HKEX”) published a consultation paper on the Review of Corporate Governance Code and Related Listing Rules<sup>1</sup> (the “HKEX Consultation Paper”) setting out proposals aimed at enhancing directors’ independence, board diversity and ESG disclosure and standards (among others). The HKEX also proposes to revise the structure and improve the readability of the Corporate Governance Code and Corporate Governance Report set out in Appendix 14 to the HKEX’s Main Board Listing Rules and Appendix 15 to the GEM Listing Rules (the “Corporate Governance Code”).

### Proposed Changes to HKEX Listing Rules and Corporate Governance Code

#### Culture of HKEX issuers

The HKEX proposes to introduce a new code provision to require an issuer’s board to align the company’s culture with its purpose, value and strategy. It will provide guidance to (a) explain the board’s role in “culture”; (b) set out the key elements commonly identified in a sound culture; and (c) recommend key issues which may be helpful to stakeholders in understanding a company’s culture.

The Consultation Paper notes that a sound culture commonly features the following elements; (a) the board is responsible for setting the company’s culture and ensuring it is embedded at all levels of the organization; (b) periodic reviews of the culture by the board; (c) facilitating effective communication and challenge

to encourage expression of a range of views; and (d) financial and non-financial incentives to promote the company’s culture.

In order to promote the importance of anti-corruption and whistleblowing, which are essential to establishing a healthy corporate culture, the HKEX proposes to: (a) introduce a new code provision requiring issuers to establish an anticorruption policy; and (b) upgrade a recommended best practice requiring issuers to establish a whistleblowing policy to a code provision under the Corporate Governance Code. The HKEX will provide further guidance to assist issuers’ compliance with the new requirements, which will set out the factors that need to be taken into consideration when formulating anti-corruption and whistleblowing policies.

The HKEX reminds issuers that they are currently required to disclose such policies or information on a “comply or explain” basis subject to materiality under the Environmental, Social and Governance (“ESG”) Reporting Guide as set out in Appendix 27 to the HKEX’s Main Board Listing Rules and Appendix 20 to the GEM Listing Rules (“ESG Guide”).

#### Independence of directors of companies listed on the HKEX

In order to promote and strengthen board independence, the HKEX proposes to introduce a new code provision requiring issuers to: (a) adopt and disclose a policy to ensure independent views and input are made available to the board; and (b) conduct an annual review of the implementation and effectiveness of the policy.

<sup>1</sup> <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/April-2021-Review-of-CG-Code-and-LR/Consultation-Paper/cp202104.pdf>

With respect to board refreshment and succession planning, in order for a listed issuer to re-elect an independent non-executive director (“INED”) serving more than nine years (“**Long Serving INED**”), the HKEX proposes to revise existing code provision A.4.3 (new code provision B.2.3) to require issuers to: (a) obtain independent shareholders’ approval of the re-election; and (b) make additional disclosure in relation to the factors considered, the process and the board or the nomination committee’s discussion in arriving at the determination explaining why such Long Serving INED is still independent and should be re-elected.

If all the INEDs on the board are Long Serving INEDs, a proposed new code provision would require listed issuers to: (a) appoint a new INED at the forthcoming annual general meeting (“**AGM**”); and (b) disclose in the shareholders’ circular the length of the tenure of the Long Serving INEDs on the board on a named basis.

Given the importance of INEDs’ objectivity and independence in scrutinising board decisions, the HKEX proposes to introduce a new recommended best practice that issuers generally should not grant equity-based remuneration (e.g. share options or grants) with performance-related elements to INEDs. This is to avoid conflict of interest which may lead to bias in INEDs’ decision-making and compromise their objectivity and independence.

### **Board diversity requirement for HKEX-listed companies**

According to a report quoted in the HKEX Consultation Paper, women held only 12.7% of Hong Kong listed companies’ directorships in 2020. As of December 2020, around 32.9% of listed companies had no female directors on their boards, and a further 37.2% had one female director.

In order to enhance gender diversity on the boards of HKEX-listed companies, the HKEX is proposing to: (a) expressly highlight that diversity is not considered to be achieved by a single gender board in the note to Main Board Listing Rule 13.92/ GEM Rule 17.104; and (b) require all listed issuers to set numerical targets and timelines to achieve gender diversity on its board and across the workforce (which includes senior management) by introducing a new mandatory disclosure obligation. Once the revised Listing Rules take effect, there will be a transition period of three years to allow issuers with single gender boards to appoint at least one director of the absent gender on their boards. IPO applicants should not have single gender boards. In this regard, the HKEX proposes to amend the relevant forms (Part 1 of Form B and Form H of Appendix 5 to the Main Board Rules / Part 1 of Form A and Form B of Appendix 6 to the GEM Rules) to require directors to provide this information on appointment. To further promote

and enhance transparency of the board and diversity information, the HKEX plans to display board diversity related information (including information such as age, gender and directorships of the directors) on the HKEX website.

Additionally, the HKEX proposes to introduce a code provision to require the board to annually review the implementation and effectiveness of its board diversity policy and make a statement in relation to the review in the issuer’s annual report.

### **Nomination committee requirement for HKEX-listed companies**

In order to strengthen the process for nominating and appointing directors and to emphasise the importance of oversight of board nomination and recruitment, it is proposed that the code provision requiring issuers to establish a nomination committee chaired by an INED and comprised of a majority of INEDs should be upgraded to a Listing Rule (Proposed new Main Board Listing Rule 3.27A / GEM Listing Rule 5.36A). The HKEX will further set out in the guidance the expected disclosures regarding INED nomination and appointment, including the channels used in searching for appropriate INED candidates, and INED candidates’ potential contribution to the board in terms of their qualifications, skills and experience. The HKEX believes that the proposal would enhance transparency and independence of the INED nomination and appointment process and promote better standards.

### **Communications with shareholders**

The HKEX proposes to upgrade to a mandatory disclosure requirement the code provision requiring issuers to disclose their shareholder communication policy and their annual review of the effectiveness of that policy in order to highlight the importance of a two-way communication between issuers and shareholders. The policy should include channels for shareholders to express their opinions on various matters relating to the issuer and steps taken by the issuer to solicit and understand shareholders’ and stakeholders’ views. The HKEX will also provide guidance setting out situations where issuers are expected to provide more information to shareholders and practical ways in which issuers can consider improving communication with shareholders (e.g. appointing a senior INED or an investor relations officer who will be given direct access to the board).

### **Other amendments**

In order to promote corporate transparency, the HKEX proposes to: (a) introduce a new Listing Rule requiring issuers to disclose directors’ attendance at general meetings in the poll results

announcements; and (b) set out in the HKEX guidance the expected disclosure in relation to the work done by an issuer's audit committee in discharging its responsibilities, including, *inter alia*: (i) how the audit committee assesses the integrity of the financial reporting disclosures and significant accounting judgments, (ii) how it monitors the relationship with the external auditors, and (iii) its process for overseeing the internal audit function.

It is also proposed to delete the current code provision requiring issuers to appoint non-executive directors for a specific term as directors are subject to retirement by rotation and shareholders' approval for re-election.

## ESG-related amendments

In order to enhance the timeliness of ESG reports disclosure, it is proposed that ESG reports should be published at the same time as the publication of the annual reports, effective for issuers' financial years starting on or after 1 January 2022. The HKEX also encourages issuers to adopt the recommendations of the Task Force on Climate-related Financial Disclosures<sup>2</sup> when making climate change-related disclosure under the ESG Guide. Additionally, it is proposed that the relationship between CG and ESG and the ESG risks in the context of risk management will be set out in the Corporate Governance Code, as follows:

*"Corporate governance provides the framework within which the board forms their decisions and build their businesses. The entire board should be focusing on creating long-term sustainable growth for shareholders and delivering long-term value to all stakeholders. An effective corporate governance structure allows issuers to have a better understanding and evaluate and manage*

<sup>2</sup> <https://www.fsb-tcfd.org/recommendations/>

*risks (including environmental and social risks) and opportunities. The ESG Reporting Guide set out in Appendix 20 to the GEM Listing Rules provides a framework for issuers to identify and consider what environmental risks and social risks may be material to them. The board should be responsible for governance of ESG matters to ensure oversight of ESG matters, as well as assessment and management of material environmental and social risks. Issuers are required to disclose environmental and social matters in ESG reports in accordance with the ESG Reporting Guide."*

## Structure of the HKEX Corporate Governance Code

The HKEX proposes to rename the "Corporate Governance Code and Corporate Governance Report" set out in Appendix 14 to the Main Board Listing Rules and Appendix 15 to the GEM Listing Rules as the "Corporate Governance Code". To improve the readability of the Corporate Governance Code, the HKEX proposes to amend the structure of the code by revising the introductory paragraphs to reflect the corporate governance reporting framework and rearranging and amending certain provisions to improve the flow and clarity of the Corporate Governance Code. The HKEX will also issue a new guidance letter, which consolidates: (a) the additional guidance proposed in the consultation paper; (b) the Guidance for Boards and Directors published in July 2018; (c) several notes currently in Appendix 14 and certain market feedback received, in order to assist issuers to comply with the corporate governance requirements.

## Deadline for comments to the HKEX Consultation Paper

The HKEX invites comments on the HKEX Consultation Paper with responses to be submitted to the HKEX by 18 June 2021.

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