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# Hong Kong Stock Exchange Consults On Board Diversity

## Introduction

The Stock Exchange of Hong Kong (**SEHK** or the **Exchange**) published a consultation paper (**Consultation Paper**) on 7 September 2012 to seek comments on its proposed amendments to the Corporate Governance Code and Corporate Governance Report (**Code**) in relation to board diversity.

The proposed Code amendments are intended to improve board effectiveness and corporate governance. A proposed requirement for issuers to report on board diversity is aimed at improving transparency and accountability.

The Consultation Paper notes the global trend towards governments and exchanges promoting board diversity either through legislation, regulation (including “comply or explain” requirements in corporate governance codes) or voluntary efforts. In addition, in its recent consultations on the Code and on a proposed Environmental, Social and Governance Reporting Guide, the Exchange received suggestions that board diversity and, in particular, gender diversity, should constitute part of an initiative to promote better corporate governance and that issuers should be required to report on their diversity policy, including gender.

The Exchange proposes to introduce a new code provision (i.e. subject to the “comply or explain” requirement) requiring an issuer’s nomination committee or board to have a board diversity policy and to disclose the policy, or a summary of the policy, in the issuer’s corporate governance report. Issuers will also be required to include any measurable objectives that it has set, and its progress on achieving those objectives.

Although the Consultation Paper focuses on the rules governing the listing of securities on the Exchange (the **Listing Rules** or **Rules**) applicable to Main Board issuers, it applies equally to the Rules of the Growth Enterprise Market.

The Consultation Paper is available on the [Exchange’s website](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201209.pdf) ([see archive](cp201209.pdf)).

## Background

The Exchange states that although diversity is broader than just gender and age diversity, the statistics on gender and age can be obtained with relative certainty and are, to an extent, representative of the diversity on issuers’ boards.

### Gender

According to the Consultation Paper, women make up 10.3% of the board members of Hong Kong’s listed issuers, while 40% of issuers have no female board directors. Research and statistics show that Hong Kong has higher gender diversity on boards of directors than China and Singapore; however, it does not score well when compared with the US, Australia and most European countries.

### Age

67% of Hong Kong issuers’ directors are between 41 and 60 years old, with the average age being 53.2 years old. The average age of female directors is slightly lower (49.1 years) than that of male directors (53.7 years). Only 23% of issuers’ directors are older than 60 while only 10% are younger than 40.

### International Practice

The Exchange notes that there is a growing trend for governments and exchanges to introduce legislation, regulation or voluntary efforts to promote board diversity. Countries including Norway, Spain, France, Belgium, Italy, Australia and Malaysia have adopted laws or regulations to enhance gender diversity on boards. For example, the Norwegian government brought in a gender quota law in 2004 which required all listed companies and State Owned Enterprises to increase the percentage of female board members to 40%.

On the other hand, countries such as the US, the UK and Singapore adopt a broader definition of diversity (which includes but is not limited to gender diversity). In 2010, the UK Corporate Governance Code was revised to incorporate diversity as a consideration in making board appointment.

### Current Status in Hong Kong

The Listing Rules and the Code adopt both mandatory and voluntary measures to promote corporate governance. A large part of the Code requires “comply or explain” on governance practice relating to board activities. Principle A.3 of the Code provides that the board of an issuer should have a balance of skills and experience appropriate for the requirements of the issuer’s business.

The following are the measures currently adopted by the Exchange to promote some aspects of board diversity:

* Main Board Rule 3.10 requires that every board of directors of an issuer must include at least three independent non-executive directors and at least one of them must have appropriate professional qualifications or accounting or related financial management expertise. Main Board Rule 3.10A further requires that independent non-executive directors must represent at least one-third of the board of an issuer by the end of 2012. There are other provisions in the Code to ensure sufficient independent representation on the board and on board committees.
* Section L(d)(ii) of the Code requires issuers to disclose in their corporate governance reports, among other things, the nomination procedures and the process and criteria adopted by the nomination committee or the board of directors (if there is no nomination committee) to select and recommend candidates for directorship during the year.

### Issues and Potential Benefits of Board Diversity

Studies have concluded that boards made up of members with different backgrounds and experience encourage greater creativity and innovation. Board members with diverse backgrounds bring different questions and concerns to the table which allows the board to consider a wider range of options and solutions to corporate issues, resulting in more effective decision-making. Some studies have indicated that female board members could strengthen company boards.

It is also suggested that gender and racial diversity on boards can enhance corporate public image. It is noted that a company’s board diversity is one of the factors that institutional investors consider before their investment in companies.

The Exchange also believes that diversity policy disclosure can lead to improvement in board quality as well as greater transparency and accountability which can enable more informed voting and investment decisions by investors. Diversity policy disclosure can lead to improved board composition since a diversity policy may encourage the board to make broader director searches, and select from a wider range of candidates, which could in turn improve board quality.

The Exchange understands that board diversity has potential drawbacks and issues such as less group cohesiveness on the board and the short supply of qualified minority candidates for directorship. However, it believes that, on balance, there is justification for promoting board diversity.

## The Proposed Amendments To The Code

### Revised Principle A.3 and New Principle A.5

It is proposed that principle A.3 “Board Composition” be amended to include “diversity of perspectives” so that in addition to considering balance of skills, experience and independence, issuers should consider diversity of perspectives when reviewing their board composition.

A new principle A.5 stating that “In carrying out its responsibilities, the nomination committee should give adequate consideration to the principles under A.3 and A.4” will be introduced so that principle A.3 “Board composition” and principle A.4 “Appointment, re-election and removal” apply also to nomination committees.

### New Code Provision A.5.6

The Exchange proposes to introduce a code provision A.5.6 stating that:

“The nomination committee (or the board) should have a policy concerning diversity of board members, and should disclose the policy or a summary of the policy in the corporate governance report.”

Issuers are expected to comply with code provisions in the Code. Issuers may choose to deviate from code provisions provided that they explain the non-compliance in their corporate governance reports. The Exchange proposes a “comply or explain” regime instead of mandatory measures to promote board diversity as it considers that board diversity is new to the Hong Kong regulatory regime, and issuers should be given time and flexibility to develop their own approach in this area.

A note under Code Provision A.5.6 will be introduced to clarify the meaning of board diversity:

“Board diversity will differ according to the circumstances of each issuer. Diversity of board members can be achieved through consideration of a number of factors, including but not limited to gender, age, cultural and educational background, or professional experience. Each issuer should take into account its own business model and specific needs, and disclose the rational for the factors it uses for this purpose.”

The Exchange explains that it considers it inappropriate to restrict the definition of diversity as issuers may have different interpretations of diversity. The Exchange intends diversity to be defined broadly and issuers should take into account factors based on their business models and needs, form their own diversity policy and disclose the relevant rationale.

### Disclosure of Board Diversity Policy

It is proposed that the mandatory disclosure requirements under section L of the Code be amended to set out the required details of diversity policy disclosure in issuers’ corporate governance reports:

“If the nomination committee (or the board) has a policy concerning diversity, this section should include the board’s policy or a summary of the policy on board diversity, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.”

In addition to seeking comments on the proposed amendments, the Exchange also seeks views on the implementation date. The alternatives proposed are 1 January 2913, 1 April 2013, 1 June 2013 or 1 September 2013. Respondents are also invited to put forward an alternative implementation date for consideration.

## How To Respond To The Consultation

A questionnaire in relation to the Consultation Paper is available on the [Exchange's website](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201209q.doc) ([see archive](cp201209q.doc)).

Respondents may complete and submit the questionnaire no later than 9 November 2012 by one of the following methods:

By email to:

response@hkex.com.hk **Re: Consultation Paper on Board Diversity**

By fax to:

1. 2524 0149
* By post or hand delivery to:
* Corporate Communications Department Hong Kong Exchanges and Clearing Limited 12th Floor, One International Finance Centre 1 Harbour View Street, Central Hong Kong **Re: Consultation Paper on Board Diversity**
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