

# July 2018 Legal and Regulatory Update

## Top stories

### Revised HKEX Corporate Governance Code

HKEX published its consultation conclusions on “Review of the Corporate Governance Code And Related Listing Rules”, and a “Guidance for Boards and Directors”. (Click: [full report](#), [press release](#); [Directors’ Guide](#)).

The “**over-boarding**” provisions have attracted most media attention. However, it is only one aspect of HKEX’s **overall focus to strengthen the accountability of the board and the nomination committee on director election** (including independent directors or “INEDs”). **Independence criteria, board diversity, and the general rigour in the nomination process are strengthened. Dividend policy transparency** is also enhanced.

The new rules will be **effective from 1 Jan, 2019**. Technically, these are to be achieved by revising the CG Code, or upgrading some Code Provisions (“CP”) into Listing Rules (“Rules”).

Relevant guidance contained in the **Directors’ Guide** (which is not part of the Listing Rules), are summarised below. In addition, it covers directors’ duties, risk management / internal controls, company secretaries’ roles (for external service providers in particular), and special considerations for weighted voting rights issuers.

#### *What you should know:*

- **INEDs (over-boarding and time commitment)** (paras 34-51 of report)
  - (Revise CP A.5.5) For electing INED who holds his **7th (or more) listed company directorship**, the **company circular to shareholders** should **give reasons** why he would still be able to devote sufficient time to the board
  - **Directors’ Guide**: factors to **assess** if a nominee may be **over-boarded** (para 2.17)
- **INEDs (enhanced independence criteria)** (paras 78-121)
  - **Cooling off periods**:
    - (i) (Revise Rule 3.13(3)) For **former professional advisors** – extend from 1 to 2 years
    - (ii) (Revise CP C.3.2) For a **former partner of auditor** to become its **audit committee member** – extend from 1 to 2 years
    - (iii) (Revise Rule 3.13(4)) **Material interests in its business activities in the past year**: introduce 1-year cooling off period

- (New) Add a **note** under the independence criteria rule, that these criteria “**should apply**” to an INED’s “**immediate family**” (i.e. spouse, his (or spouse’s) child or step-child, natural or adopted, under 18) in assessing independence
- (New “**Recommended Best Practice**”) **Disclose** in the corporate governance report (“CG Report”), an INED’s **cross directorships** or significant links with other directors
- **Board diversity** (paras 53-68 of report)
  - Upgrade CP (A.5.6) to a Rule, requiring issuers to have a **diversity policy** and **disclose the policy / a summary** in the CG report
  - (Revise CP A.5.5) **More disclosure**, in **circular to shareholders** accompanying the resolution to elect the director:
    - (i) The process used for identifying the nominee
    - (ii) The perspectives, skills and experience he is expected to bring to the board
    - (iii) How he would contribute to diversity of the board
- (New) Disclose **nomination policy** in **CG Report**, which should set out the board’s consideration of Code Principle (A.3) (i.e. a board should have a balance of skills, experience, and diversity of perspectives) (paras 122-129)
  - **Directors’ Guide: considerations in developing a nomination policy** (para 3.9) and a **diversity policy** (para 4.9). “**Board skills matrix**” (para 4.10-2) is also referenced as a tool to assess diversity
- (Revise CP A.2.7) **INEDs should meet annually with the Chairman**, in the absence of the other directors, giving feedback (paras 138-143)
- (New) Disclose **dividend policy** in the **annual report** (paras 144-149)

*What you should do/watch out for:*

- **Management:**
  - **Immediate action: inform your directors** on the rule changes, and forward to them the **Directors’ Guide**
  - **Assess impact on your board, nomination committee, board policies/processes** (e.g. nomination policy and process, diversity policy), **disclosure** (annual report/CG report, AGM circular on director election)
- **Nomination Committee:** rule changes will result in greater demand on it and the board, for ensuring the balance of skills of directors, enhanced independence criteria, and diversity
- **INEDs:** assess impact of rule changes on you

## Also in this issue

### Regulators

(i) HKEX published its [Enforcement Newsletter](#), covering 1H 2018.

The theme is the roles and responsibilities of non-executive/independent directors. HKEX observed that firstly, there has been “too much reliance on management”; secondly, that some directors do not appear to understand the importance of their role.

There are useful examples and elaboration on these observations!

“Compliance highlights” section features a useful case for “notifiable transactions” (Chapter 14) interpretation.

The enforcement cases cited are principally blatant breaches of Listing Rules and related internal controls failures; or failing to co-operate with HKEX.

### *What you should know/watch out for:*

On Directors’ duties:

- (Common defence) “I relied on executive directors”

HKEX reminder:

- Executive and non-executive directors have the same level of duties under the Listing Rules
- “Level of reasonable care, skill and diligence” — combined objective (i.e. a “hypothetical reasonably diligent person”), and subjective tests (i.e. director with greater personal knowledge must meet higher standards. E.g. a qualified accountant as an audit committee member)
- Take a “diligent and intelligent interest” in issuer’s affairs and information provided
- Apply an “enquiring mind” to their responsibilities: not “box ticking or spell checking exercise”
- May delegate; but does not absolve directors from responsibilities

- (Common defence) “No reason for us to suspect anything was wrong”

HKEX reminder:

- Independent judgment needed
- Seek additional information if needed

- Must **familiarise** themselves with the **company’s business**
- **Challenge** other directors, **regardless of how dominant they are**
- **E.g. in disciplinary hearings**, will consider if a **director has demonstrated their own independent judgment**, e.g. by **raising questions of executive management/ professionals**; including obtaining **independent/ professional advice**, or **other positive steps** to make own enquiries

**“Compliance highlights” section** (interpretation of **“transaction”** under **Chapter 14**)

- Case: issuer subscribed for “wealth management products” by banks
- Misunderstood Chapter 14, that products with low redemption risks are similar to cash and deposits
- In fact, such subscription amounts to a **“transaction”**
- Failed to meet Chapter 14 procedural requirements

**(ii) SFC announced consultation conclusions on amendments to the Codes on Takeovers and Mergers and Share Buy-backs.** After gazetting, they became **effective on 13 July**. (Click: [press release](#); [consultation conclusions](#))

These include raising the **independent shareholder approval** threshold for **“whitewash waivers”** (regarding the obligation to make a “general offer” after a “change in control”), from a simple majority to **75%**. This aims to combat attempts to manufacture “shell companies”, by circumventing the general offer obligation.

The Takeovers Panel is also **empowered to require compensation** to be paid to shareholders who have suffered as a result of a **breach of the Codes**.

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