

# Nov/Dec 2021 Legal and Regulatory Update

## Top stories

### HKEX consultation conclusions on corporate governance & directors' guide

HKEX published consultation conclusions on enhancements to the Corporate Governance Code and Corporate Governance Report. ([Press release](#); [full document](#))

Most proposals are adopted EXCEPT these notable modifications:

- *(NOT adopted)* independent shareholder approval of re-election of independent director (“INED”) serving more than 9 years
  - But if all INEDs have served more than 9 years, a new INED be appointed during financial year commencing on or after 1 Jan 2023
- *(Modified)* mandatory nomination committee: can be chaired by board chairman (or INED, as proposed)
- *(Modified)* diversity — setting of targets at board level (not workforce level, as proposed)

The revisions are effective from financial year commencing on or after 1 Jan 2022, save for some areas (*see below: new INED appointment if all INEDs serve 9 years; or “single gender boards”*).

In terms of the technical approach, the revisions introduce new/upgrade “Code Provisions” (“CP”; subject to “comply or explain”), “Recommended Best Practices” (“RBP”; which are voluntary). Some Code Provisions are upgraded to Listing Rules. For enhancing disclosure, there are new “Mandatory Disclosure Requirements” (“MDR”; disclosed under corporate governance reports).

HKEX also published an updated [Corporate Governance Guide for Boards and Directors](#) (“HKEX directors’ guide”), providing useful guidance. E.g. on new areas like culture, anti-corruption. These are referenced below.

Key revisions include:

- **Corporate culture**
  - *(New CP A.1.1)* stresses the board’s roles
    - (i) **Establish** company’s purpose, values, and strategy, and satisfy that these and its culture are aligned
    - (ii) **All directors** must act with integrity, lead by example, and promote the desired culture

- (iii) Culture should instil and **continually reinforce across** the organisation **values** of “**acting lawfully, ethically and responsibly**”
- **HKEX directors’ guide**
  - (i) Addresses **roles of the board** as well as **management** (P.9)
  - (ii) **List of questions for the board** (P.11)
  - (iii) **Disclosure** (e.g. *vision, values, strategy, alongside culture — how all these affect the business model, purpose, and board evaluation*) (P.12)
  - (iv) **Related** theme and disclosure (e.g. **board evaluation**)
- **Whistleblowing and anti-corruption policies**
  - (New CP D.2.6) **Whistle-blowing policy and systems:** to be **monitored** by the audit committee or a designated committee comprising of a majority of INEDs
  - (New CP D.2.7) **Policies/systems** to support **anti-corruption** laws/regulations
  - **HKEX directors’ guide:** key elements of such policies; disclosure (P.13)
- **Board independence, refreshment and succession planning**
  - (Modified proposal) **INED(s) serving more than 9 years:**
    - (i) (New CP B.2.3) **Additional disclosure for re-election:** why such INED still independent (*i.e. factors considered, process and the board/ nomination committee’s discussion in arriving at such determination*)
    - (ii) (New CP B.2.4) If **all INEDs served more than 9 years**, (a) disclose their respective length of **tenure** on a named basis, (b) (*during financial year commencing on or after 1 Jan 2023*) **appoint a new INED**
  - **Others:**
    - (i) (New CP) **Policy** in place, to ensure **independent views are available to the board**, and **annual review** of its effectiveness
    - (ii) (*Upgraded to Rule; modified proposal*) **mandatory nomination committee**, chaired by either board chairman or INED; comprising a majority of INEDs
    - (iii) (*New Rule*) **disclosure of directors’ attendance at general meetings in poll results announcements**
    - (iv) (*New RBP*) generally should **not grant equity-based remuneration to INEDs**, for objectivity and independence

- **Diversity**
  - **Single gender board** not considered a diverse board
  - (*New MDR*) set and disclose mandatory **numerical targets and timelines** for **achieving gender diversity** at **board level**
  - (*New MDR*) set and disclose **gender ratio** at **workforce level** (*including senior management*); any plans or measurable objectives for achieving gender diversity; or mitigating factors making this more challenging/less relevant
  - (*New CP*) boards required to **review progress of diversity policy annually**
  - **Transitional arrangements for single gender boards:** to appoint at least one director of the absent gender by **31 Dec 2024**
  - **HKEX directors' guide** : guidance on **disclosure** (*P.22*); including the use of a **board skills matrix** (*P.23*)
- **Communications with shareholders**
  - (*Upgraded to MDR*) disclosure on **shareholders communication policy**, and **annual review** of its effectiveness
  - Two-way communication: dissemination of information to shareholders; solicit feedback
- **ESG**
  - New **introductory paragraph** added to the **Code**, elaborating on **linkage** between corporate governance and ESG
  - **ESG report to be published at the same time as annual reports** (*i.e. within 4 months of year-end, instead of 5 months for ESG reports now*)
- **Re-arrange order of the Code for a better flow**
  - No substantive changes

***What you should do/watch out for:***

- **Update the board** and relevant teams on the revisions, after **management's assessment** with **proposed actions** (*in light of implementation timeframe*), e.g. need to appoint new directors; mandatory nomination committee; corporate culture, publication time of ESG report, other gaps in policies/processes/disclosure
- Note **enhanced disclosure** in **corporate governance report** (*for report covering year commencing on or after 1 Jan 2022*); consider **early-adoption** where appropriate

## Hot Trends

### The Path to Recovery and Resiliency

#### - *Why Human Capital Management Matters* (Nasdaq Governance Solutions whitepaper)

More companies/ boards recognise that human capital is critical in driving long-term value!

- **Investor perspectives**
- **Re-evaluating purpose/vision/mission**
- **Examples of changing corporate values**
- **Innovative partnerships and innovations**

[Read paper](#)

Find out how company values are shifting to accelerate human capital management!

## Also in this issue

### Regulators

(i) [HKEX's latest Listed Issuer Regulation Newsletter](#) covers **various themes relevant to listed issuers**, e.g. **directors' responsibilities when assessing transactions**. HKEX explains its **expectations on directors** when conducting transactions.

It also reminds directors of their duties in lending transactions.

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

- **Evaluate the benefits expected from the transaction**
  - Whether conducive to implementing issuer's **strategy**?
  - Consistent with issuer's **business plan and direction**?
  - E.g. **business in a different industry**: weigh prospects of that industry against risks and issuer's capabilities to operate the new business
- **Make due enquiries on the acquisition target**
  - **Size and complexity**
  - **Directors' knowledge** in the relevant business/ industry
  - Should consider extent of **due diligence** and **expert advice** needed

- **Critically assess the value of target** (*fair + reasonable?*)
  - With reference to information obtained through directors’ enquiries
  - **Exercise own judgment**; not to overly rely on one single source or biased information
  - E.g. business **valuation**: need for **independent assessment** of the assumptions; **review** of business operations
- **Assess all transaction terms** (*reasonableness + adequacy?*)
  - **Settlement/payment** terms
  - Guard against **failure by the counterparties** in fulfilling contractual obligations
  - E.g. vendor’s ability to fulfill warranties/ guarantees
  - E.g. target is a new business: caution in relying on profit guarantee

**(ii) ESG: further HKEX initiatives**

By way of background, the (*international*) Task Force on Climate-Related Financial Disclosure (“TCFD”) published recommendations on **climate-related financial disclosures**, which are endorsed by investors generally.

**Hong Kong’s** Green and Sustainable Finance Cross-Agency Steering Group (*of which HKEX is a member*) announced in Dec 2020, that climate-related disclosures **aligned with the “TCFD recommendations”** will be **mandatory** across relevant sectors **no later than 2025**.

In light of this direction, HKEX recently published:

- (i) (*Nov 2021*) a [Guidance on Climate Disclosures](#) to provide practical guidance to facilitate the process. There are useful guidance, including on the “**governance**” aspects, as summarized below.
- (ii) (*Dec 2021*) a [Practical Net-Zero Guide for Business](#) for Hong Kong listed issuers, on charting their net zero carbon journey. Through its sustainable and green exchange (**STAGE**) platform, it also launched a new service displaying Hong Kong-listed companies ESG metrics. ([STAGE Product Repository](#))

The guide is a technical one that takes companies through the necessary processes to develop an appropriate net-zero pathway. The repository initiative will help provide a consolidated view of ESG ratings from different providers, facilitating investors in their investment decisions.

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

#### Useful guidance on “governance” (TCFD guide)

- **Roles and responsibilities of board and management** (P.7)
- **Common governance structures** (P.8)
  - “**Integrated**” (i.e. existing board committees)
  - “**Dedicated**” committee approach
- **Key elements of disclosure** (P.11)
  - **Example** of hypothetical company (P.12)

## Legislation

### **Competition Commission takes cleansing service cartel case before Competition Tribunal, against 2 companies and their named directors.** ([Press release](#))

It is alleged that from May 2016 to Aug 2018, the companies exchanged commercially sensitive information in relation to 17 tenders (*total contract sum: HK\$180m*) submitted to the **Hong Kong Housing Authority re: cleansing services**. Such conduct amounts to “**price fixing**”, a serious anti-competitive conduct in contravention of the **First Conduct Rule** of the Competition Ordinance.

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

- “**First Conduct Rule**” means — parties acting together with an **agreement**, and/or engaged in a **concerted practice**, whose **object or effect** is “to prevent, restrict or distort” competition in HK
- Reinforces that “**cartel actions**” i.e. **price fixing**, **market sharing**, and **bid-rigging**, is a **priority enforcement area**

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