

June 2024 Legal and Regulatory Update

Top stories

HKEX consults on Corporate Governance Code

HKEX published a consultation paper on proposed enhancements to the **Corporate Governance Code** and related Listing Rules. The consultation period will close after **16 August**. ([Press release](#); [full document](#)).

It is intended that the proposals will come into effect on **1 Jan 2025**, and apply to **corporate governance reports** (“CG reports”)/annual reports for **financial years commencing on or after** such date.

As regards **proposals on independent directors (“INEDs”) serving more than 9 years (“Long-serving INEDs”) and overboarding**, there will be a **3-year transitional period** — effective on 1 Jan 2028, with compliance required by the conclusion of the AGM following 31 Dec 2027.

The proposals address 5 broad themes: **board effectiveness, independence of Long-serving INEDs, board and workforce diversity, risk management and internal controls, and enhanced disclosure re: dividends.**

In terms of the technical approach, the proposals introduce new “Code Provisions” (“CP”; *subject to “comply or explain”*). Some Code Provisions are upgraded to Listing Rules. For enhancing disclosure, there are changes in “Mandatory Disclosure Requirements” (“MDR”; *disclosed under CG reports*).

It is noted that **HKEX will provide training and guidance materials** (*e.g. areas to be covered in a board performance review*). Issuers are encouraged to visit its [Corporate governance practices portal](#), and [Board diversity hub](#) (*a repository containing information on issuers’ board diversity*).

Key proposals are summarised in our Appendix I. (*For details of amendments- see Appendix I of consultation document*).

What you should do/watch out for:

- Note the **consultation period**, for making responses as appropriate
- **The board** and relevant teams be updated on the proposals, following **management’s initial assessment** of the impact (*in light of implementation timeframe*), e.g. *Lead INED*, overboarding, Long-serving INEDs, other gaps in policies/processes/disclosure
- **Detailed analysis by management** for board discussions in due course
- Note **enhanced disclosure** in CG reports, consider early-adoption where appropriate

Also in this issue

Legislation

(i) The Privacy Commissioner for Personal Data (“PCPD”) published “Artificial Intelligence: Model Personal Data Protection Framework” to provide internationally well-recognised and practical **recommendations and best practices** to assist organisations to **procure, implement and use artificial intelligence (“AI”)**, including generative AI, in compliance with **Personal Data (Privacy) Ordinance (“PDPO”)** and its **Data Protection Principles (“DPP”)**. ([Press release](#); [full document](#); [leaflet](#))

In general, organisations sourcing third-party AI solutions should adopt a **risk-based approach**. The Model framework addresses 4 themes: **AI strategy and governance, risk assessment and human oversight, customisation of AI models and implementation and management of AI systems, communication and engagement with stakeholders**.

An **overview summary of recommendations** is set out in **Appendix II**. Our focus is on the governance, instead of the technical, aspects.

(ii) Competition Tribunal “cartel” case re: government subsidy scheme ([Press release](#))

This is a **cartel case** re: government subsidy under its distance business programme (“D-Biz”).

Between May 2020 and Sept 2021, some IT service providers (*Multisoft Limited and its parent company, BP Enterprise Company Limited and Noble Nursing Home Company Limited, KWEK Studio Limited*), when providing quotations for IT solutions in applications for government subsidy, engaged in **price-fixing, market-sharing, bid-rigging and/or sharing competitively sensitive information**, in contravention of the **First Conduct Rule** of the Competition Ordinance.

The Tribunal ordered against the defendants.

The Competition Commission stresses in its press release, that combating anti-competitive conduct that aims to **abuse public funding** is one of its **top priorities**.

What you should watch out for/do:

- “**First Conduct Rule**” means — parties acting together with an **agreement**, and/or engaging in a **concerted practice**, whose **object or effect** is “**to prevent, restrict or distort**” competition in HK
- The **first cartel case** to use **data screening** to identify suspicious patterns that might be indicative of anti-competitive conduct

- The **first cartel case** to successfully **collaborate with a public body** (*Hong Kong Productivity Council*) which provided crucial **information/data** for screening

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Appendix 1 Summary of HKEX corporate governance proposals

I. BOARD EFFECTIVENESS

- *(New CP)* **Designation of “Lead INED”**
 - Issuers **without an independent board chair** to designate a “Lead INED”
 - To facilitate and strengthen communication among INEDs; between INEDs and the rest of the board; and with shareholders
- *(New rule/revised MDR)* **Mandatory director training**
 - For **all directors**; covering **specified topics**
 - roles and responsibilities of the board/committees and directors, and board effectiveness
 - issuers’ obligations and directors’ duties under HK law and Listing Rules, and key legal/regulatory developments
 - corporate governance and ESG (*including developments on sustainability or climate-related risks and opportunities relevant to the issuer/business*)
 - risk management and internal controls
 - industry-specific developments, business trends and strategies relevant to the issuer
 - **“First-time directors”**: (*minimum*) **24 training hours** within **18 months** of appointment
 - appointed as a director of an issuer listed for the first time; or
 - not served as a director of an issuer listed for a period of 3 years or more prior to their appointment
 - **Enhanced disclosure** for each director: number of hours; topics/format of training; names of relevant training providers (*if external*)
- *(Upgrade to CP)* **Board performance review**
 - At least **every two years**
 - Issuer’s **discretion re: format** (*e.g. internal or external providers*)
 - Focus on the **board’s performance as a whole** (*not individual director performance*)
 - **Specific disclosure**: scope of review; process and findings including improvement; measures taken/planned to address the same
- *(New CP)* **Maintain and disclose board skills matrix**

- **And enhanced disclosure:** existing skills mix; how the skills/diversity serves the issuer's purpose/values/strategy/culture; details and plans to acquire further skills
- *(New rule/new MDR)* **Overboarding INED and directors' time commitment**
 - **Hard cap on overboarding** (*NOT more than 6 listed issuer directorships*)
 - **Nomination committee:** to **annually assess and disclose** each director's time commitment and contribution

II. INDEPENDENCE OF INEDS

- *(New rule)* **Long-serving INEDs**
 - **Not considered as independent**
 - Allowed to serve as INED again after a cooling-off period of 2 years

III. (New CP/new Rule/MDR) BOARD AND WORKFORCE DIVERSITY

- Various measures
 - *(New CP)* **Nomination committee:** at least 1 director of a different gender
 - *(Upgrade to MDR)* Results of **annual review of implementation** of board diversity policy (*including progress towards objectives*)
 - *(New rule)* Set and disclose a **workforce diversity policy** (*including senior management*)
 - *(MDR)* **Separate disclosure** of gender ratio of senior management and workforce

IV. (Upgrade to MDR) RISK MANAGEMENT AND INTERNAL CONTROLS

- **Enhanced disclosure on annual reviews** of such systems
 - Including supporting information on board's conclusion of effectiveness of the systems (*e.g. confirmation received from management, etc.*), and details of review findings

V. (New MDR) DIVIDENDS

- Including enhanced disclosure of **dividend policy** and **dividend decisions**
 - E.g. **dividend decisions**
 - reasons for **material variation** in dividend rate compared with previous period
 - **if no dividend declared:** reasons for decision and measures to enhance investors' return

Appendix II Summary of PCPD recommendations

(Note: page references refer to PCPD full document)

I. AI STRATEGY AND GOVERNANCE (P.11)

- **AI strategy**
 - **Key principle: accountability**
 - Demonstrate **commitment of top management** to **ethical and responsible** procurement, implementation and use of AI
 - Provide **directions on**
 - **purposes** for which AI solutions may be procured
 - how AI systems should be **implemented** and **used**
 - **Elements**
 - e.g. define the functions that AI systems would serve; set ethical principles; determine unacceptable uses
- **Governance considerations for procuring AI solutions**
 - Generally involves engaging third parties to **customise** AI systems or buying **off-the-shelf** systems
 - Governance considerations (P.13)
 - e.g. purposes of using AI; key privacy and security obligations and ethical requirements; international technical and governance standards
- **Governance structure**
 - **Key principles: accountability/human oversight**
 - Establish an **internal governance structure** with sufficient resources, expertise and authority
 - **AI governance committee**
 - **report to board** and **oversee whole life cycle** of AI solutions from procurement, implementation, and use to termination
 - oversight **across business**, not to be constrained by division (*e.g. risk and compliance*)
 - participated by **senior management** and **interdisciplinary collaboration**
 - **led** by a **C-level** executive
 - examples of roles and responsibilities (P.19)

- **Training and awareness raising**
 - **Key principle: accountability**
 - E.g. for AI system users: compliance with data protection laws/regulations/internal policies; cybersecurity risks; general AI technology
 - Training for other personnel, e.g. legal and compliance professionals (P.21)
 - Roles of **human reviewers** (P.21)

II. RISK ASSESSMENT AND HUMAN OVERSIGHT (P.23)

- **General: a risk-based approach**
 - In the **procurement, use and management** of AI systems
 - **Comprehensive risk assessment**
 - **identify, analyse and evaluate** risks (*including privacy risks*)
 - **Risk management system** formulated/implemented/documentated/maintained
 - **throughout entire life cycle** of system
 - **Cross-functional team** to conduct risk assessment
 - during **procurement** process or **significant updates**
 - All risks assessment be properly **documented**
- **Risk factors**
 - **Key principles: beneficial AI/data privacy/fairness**
 - **Key factors** considered in **risk assessment**
 - e.g. allowable uses of data (**DPP3**)
(Under DPP3, personal data must not be used for new purposes without the prescribed consent of data subjects)
 - e.g. volume of personal data (**DPP1**)
(Under DPP1, amount of personal data to be collected shall be adequate but not excessive)
- **Determining level of human oversight**
 - **Key principle: human oversight**
 - **Risk-based** approach: type/extent of **risk mitigation** measures **proportionate** to risks
 - **Human oversight** is a key measure for mitigating risks

- Examples of AI use cases that may incur higher risk (P.29)

- **Risk mitigation trade-offs (P.30)**

III. CUSTOMISATION OF AI MODELS AND IMPLEMENTATION AND MANAGEMENT OF AI SYSTEMS (P.32)

- **Data preparation for customisation and use of AI**

- **Key principles: data privacy/fairness**
- 4 aspects of **data preparation**
 - compliance with requirements of PDPO
 - minimisation of personal data involved in customisation and use of AI
 - management of data for customising and using AI
 - proper documentation of handling of data

- **Customisation and implementation of AI solutions**

- **Key principles: transparency and interpretability/reliability, robustness and security**
- **Rigorous testing and validation in proportion to risks** involved
- Recommended measures (P.38)

- **Management and continuous monitoring of AI systems**

- **Key principles: reliability, robustness and security/human oversight**
- **Monitored and reviewed continuously**
 - risk factors may change
- Consider establishing an **AI incident response plan** (P.45: *detailed elements*)

IV. COMMUNICATION AND ENGAGEMENT WITH STAKEHOLDERS (P.47)

- **Key principle: transparency and interpretability**

- **Information provision**

- Communicate and engage effectively and regularly with stakeholders
 - in particular **internal staff, AI suppliers, individual customers and regulators**
- **Level of transparency will vary** depending on stakeholders
- Effective communication is essential to **building trust**

- **Data subject rights and feedback**
- **Explainable AI**
 - Key to **building trust** with stakeholders
 - Making the decisions and output of AI explainable
- **Language and manner**
 - Plain language, clear and understandable to lay persons