

30 Nov 2017

Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Submitted via email to: response@hkex.com.hk

RE: Concept Paper on Review of the Corporate Governance Code and Related Listing Rules

Dear Sir/Madam,

BlackRock¹ is pleased to have the opportunity to respond to the “Consultation Paper on Review of the Corporate Governance Code and Related Listing rules” (the Consultation Paper), issued by the Hong Kong Exchanges and Clearing Limited (HKEX).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Concept Paper and will continue to contribute to the thinking of the Hong Kong Exchanges and Clearing Limited on any issues that may assist in the final outcome.

Executive summary

BlackRock welcomes the HKEX’s focus on improving the quality of the board in the current consultation with the proposals to tighten the definition for director independence and limit the number of directorship for INEDs, among others. However, we think more needs to be done in order to achieve any meaningful improvement in the quality of corporate governance in Hong Kong. Such measures, as elaborated in our consultation response enclosed in this letter, include:

1. Differentiate the role of an executive director from that of a non-executive director when limiting the number of directorships that may be held by a given director. The role of chairman should also be treated differently from that of a non-chairman;
2. Provide more detailed guidelines for the Diversity Policy that is proposed to be mandated to all companies to avoid a boiler plate policy that lacks substance;
3. Make it mandatory to disclose any information that would facilitate shareholders’ assessment of the quality of the director candidates by incorporating the requirement in the Listing Rules as opposed to a Code Provision or Recommended Best Practice;
4. Require companies to appoint a Senior Independent Director to encourage more accountability of independent directors;
5. Consider adding in the Listing Rules a statement that it is unlikely that an individual could be deemed independent if they are subject to a cooling off period.

¹ BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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Moreover, we would like the HKEX to consider the following suggestions to areas that are not covered in the Consultation Paper:

1. Introduce a process that will give minority shareholders a greater voice with respect to the election of directors. Given the dominance of controlling shareholders and the influence of controlling shareholders on the selection of INEDS we would like to see a process whereby the votes by shareholders holding less than 15% (minority shareholders) are disclosed separately. Where an INED does not get majority support from the minority shareholders he/she is required to stand again for re-election at the following AGM. This process continues until the INED receives majority support from minority shareholders. Once majority support is achieved the INED is subject to usual retirement by rotation rules;
2. Increase the minimum independence requirement from the current one third to majority. Again in light of the predominance of controlling shareholders among Hong Kong companies, a minimum independence level of one third is deemed largely insufficient and the HKEX should take the lead in Asia to promote the concept of an independent board.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2017-Review-of-the-CG-code-and-Related-LRs/Consultation-Paper/cp2017111.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

PART 1: INDEPENDENT NON-EXECUTIVE DIRECTORS

Overboarding and INED's time commitment

1. Do you agree with our proposed amendment to Code Provision (“**CP**”) A.5.5 (on a “comply or explain” basis) so that in addition to the CP’s current requirements, the board should also explain, if the proposed independent non-executive director (“**INED**”) will be holding his seventh (or more) listed company directorship, why he would still be able to devote sufficient time to the board?

Yes

No

Please give reasons for your views.

While we support the proposed limit of seven directorships we believe this should apply to non-executive directorships as opposed to executive directorships. A full time executive of a Hong Kong listed company should be limited to only one non-executive role of an entity not related to the entity of which he/she is a full time executive. The CP should also distinguish between the role of a non-executive chairman and an INED. In our view the role of the chairman takes up to three times as more time as an INED.

Board diversity

2. Do you agree with our proposals to upgrade CP A.5.6 (on a “comply or explain” basis) to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their corporate governance reports?

Yes

No

Please give reasons for your views.

There is growing research to support the notion that diverse teams drive better decision making. We believe that boards should comprise competent directors who have a diversity of skills and experience and be selected via a transparent process.

Based on our analysis of reporting on diversity policies we have found the policies to be perfunctory in nature and tend to have a narrow focus on gender diversity. While gender is only one form of diversity it does relates to 50% of the population. In our view, if the board can address gender diversity other forms of diversity will also be addressed as the culture within the organisation changes.

Since the introduction of the CP in 2013 there has been little change in gender diversity of Hong Kong listed companies. Hong Kong boards should be providing more transparency around nomination processes and this should be extended to gender diversity.

In addition to upgrading CP A5.6 to a Rule there needs to be an enhancement to the wording as well as guidance with respect to disclosures on diversity. The Australian Securities Exchanges' Principles of Corporate Governance Principles in 2014 introduced new recommendations on diversity. Prior to the mandating of the new recommendations the level of women on boards at ASX 200 companies was 14%² and disclosures were considered perfunctory. Since the introduction of the diversity recommendations the percentage has risen to 26%³ and disclosures have improved significantly⁴.

Based on the success of the Australian recommendations BlackRock would like to recommend the revised Rule include a requirement for the board or relevant committee to:

- Set measurable objectives for achieving gender diversity and to assess annually both the objectives and the company's progress in achieving them;
- Disclose at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them, and the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined "senior executive" for these purposes).

Further, we suggest the Code adopt the ASX Corporate Governance Principles "Suggestions for the content of a diversity policy" as follows:

In addition to addressing the matters referred to above in the new Rule, a listed company's diversity policy could:

1. Articulate the corporate benefits of diversity in a competitive labour market and the importance of being able to attract, retain and motivate employees from the widest possible pool of available talent.
2. Express the organisation's commitment to diversity at all levels.
3. Recognise that diversity not only includes gender diversity but also includes matters of age, disability, ethnicity, marital or family status, religious or cultural background, and sexual orientation and gender identity.
4. Emphasize that in order to have a properly functioning diverse workplace, discrimination, harassment, vilification and victimization cannot and will not be tolerated.
5. Ensure that recruitment and selection practices at all levels (from the board downwards) are appropriately structured so that a diverse range of candidates are considered and that there are no conscious or unconscious biases that might discriminate against certain candidates.
6. Identify and implement programs that will assist in the development of a broader and more diverse pool of skilled and experienced employees and that, over time, will prepare them for senior management and board positions.
7. Recognise that employees (female and male) at all levels may have domestic responsibilities and adopt flexible work practices that will assist them to meet those responsibilities.
8. Introduce key performance indicators for senior executives to measure the achievement of diversity objectives and link part of their remuneration (either directly or as part of a "balanced scorecard" approach) to the achievement of those objectives.

² Reference BlackRock's 2012 paper

³ <http://aicd.companydirectors.com.au/advocacy/board-diversity/mixed-news-in-latest-report-on-progress-to-30-per-cent-target>

⁴ Reference BlackRock 2016 paper

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BlackRock would also like to see CP B1.9 amended to require the board to conduct annual evaluation of the performance of the board and each director and that every third year the evaluation review be conducted by a specialist external facilitator.

Well-functioning boards are critical to effective board discussion and debate which drives better investment decision making.

3. Do you agree with our proposal to amend CP A.5.5 that it requires (on a “comply or explain” basis) the board to state in the circular to shareholders accompanying the resolution to elect the director:

- (i) the process used for identifying the nominee;
- (ii) the perspectives, skills and experience that the person is expected to bring to the board; and
- (iii) how the nominee would contribute to the diversity of the board.

Yes

No

Please give reasons for your views.

We are supportive of the above information being included in meeting circulars to allow shareholders to make an informed decision on the election/re-election of directors. However, we think the requirement should be part of the Listing Rules rather than a CP given its importance.

We would also like to see a requirement for disclosure of the perspectives, skills and experience of each director in the company’s annual report. Currently the requirement is for companies to disclose name, age, qualifications and current and former directorships.

The inclusion of the above requirements will only be of benefit to shareholders if more information of the directors not seeking re-election is also disclosed as this will allow shareholders to have a more informed view of the board as a whole.

4. Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) to reflect the upgrade of CP A.5.6 (on a “comply or explain” basis) to a Rule (Rule 13.92) requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their Corporate Governance Reports?

Yes

No

Please give reasons for your views.

We would like to see a requirement for companies to disclose their full diversity policy on their website where they choose to disclose a summary of it in the annual report.

Factors affecting INED’s independence

A. Cooling off periods for former professional advisors

5. Do you agree with our proposal to revise Rule 3.13 (3) so that there is a three-year cooling off period for professional advisors before they can be considered independent, instead of the current one year?

Yes

No

Please give reasons for your views.

While we agree that lengthening the cooling off period is an improvement, ideally we would like to see the Listing Rules to include a statement that former professional advisers are unlikely to be considered independent in any circumstance. Given that the current requirement is only for boards to be a third independent and the controlling shareholders, whose existence are prevalent among Hong Kong companies, are allowed to vote on the election of independent directors, we believe it is essential to have stricter definitions for independence. These individuals can still serve on the board as NEDs.

We make the same argument for the other individuals that require a cooling off period to be considered independent under the current rules and requirements.

6. Do you agree with our proposal to revise CP C.3.2 (on a “comply or explain” basis) so that there is a three-year cooling off period for a former partner of the issuer’s existing audit firm before he can be a member of the issuer’s audit committee?

- Yes
 No

Please give reasons for your views.

A demonstrably independent audit is the cornerstone of good corporate governance. Ensuring the independence of the external audit process is a key issue for investors. In our view, where a former partner joins the board within three years of leaving the audit firm risks impairing the independence of the external audit.

However, we disagree in leaving this as a Code Provision subject to “comply or explain”. We would like this requirement to be part of the Listing Rules given its importance. Moreover, we would like to see an additional requirement that the audit signing partner be prohibited from joining the board for a period of three years from ceasing as a signing partner. Such a requirement should ensure the continuance of an independent external audit.

B. Cooling off period in respect of material interests in business activities

7. Do you agree with our proposal to revise Rule 3.13(4) to introduce a one-year cooling off period for a proposed INED who has had material interests in the issuer’s principal business activities in the past year?

- Yes
 No

Please give reasons for your views.

We disagree with the proposed introduction of a one-year cooling off period. We think a same cooling off period of three years should be applied to a person who has had material interests in the issuer’s principal business activities to be qualified as an INED.

Similarly, we recommend the HKEX apply the same cooling off period of three years across the independent-director criteria in Rule 3.13. This means the cooling off period for the following individuals would need to be increased to three years from the current two years before they can be considered as an INED candidate:

1. Those who are or were “connected with a director, the chief executive or a substantial shareholder of the issuer”;

2. Those who are or were “an executive or director (other than INED) of the issuer (or its holding or subsidiary companies, or core connected persons)”;

C. Cross-directorships or significant links with other directors

8. Do you agree with our proposal to introduce a new Recommended Best Practice A.3.3 (i.e. voluntary) to recommend disclosure of INEDs’ cross-directorships in the Corporate Governance Report?

- Yes
 No

Please give reasons for your views.

Our view is that this should be part of the Listing Rules as opposed to a RBP.

D. Family ties

9. Do you agree with our proposal to introduce a Note under Rule 3.13 to encourage inclusion of an INED’s immediate family members in the assessment of the director’s independence?

- Yes
 No

Please give reasons for your views.

Such disclosure should be included in Rule 3.13.

10. Do you agree with our proposal to adopt the same definition for “immediate family member” as Rule 14A.12(1)(a) which defines an “immediate family member” as “his spouse, his (or his spouse’s) child or step-child, natural or adopted, under the age of 18 years”?

- Yes
 No

Please give reasons for your views.

PART2: NOMINATION POLICY

11. Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) of Appendix 14 to require an issuer to disclose its nomination policy adopted during the year?

- Yes
 No

Please give reasons for your views.

We believe that boards should undertake an appropriate search for competent directors. Board quality is a factor taken into account in the investment process and currently most Hong Kong listed companies provide little information to allow investors to assess the process undertaken by the board to identify suitable candidates. A robust process utilising a skill matrix with a focus on the long term in our view will result in a high quality board.

PART3: DIRECTORS' ATTENDANCE AT MEETINGS

Director's attendance at general meetings

12. Do you agree with our proposal to amend CP A.6.7 (on a "comply or explain" basis) by removing the last sentence of the current wording (i.e. they should also attend general meetings and develop a balanced understanding of the views of shareholders.)?

- Yes
 No

Please give reasons for your views.

We strongly object to this amendment.

It is critical that directors attend general meetings. If a director does not have the time to attend general meetings the question has to be asked as to whether or not they should be on the board. Where a director cannot make a general meeting (and presumable this includes the annual general meeting) a cogent explanation should be forthcoming to allow shareholders to decide if that particular director should be supported when up for re-election.

Chairman's annual meetings with INEDs

13. Do you agree with our proposal to revise CP A.2.7 (on a "comply or explain" basis) to state that INEDs should meet at least annually with the chairman?

- Yes
 No

Please give reasons for your views.

Given the prevalence of block shareholders (both family and state) in the Hong Kong market the role of INEDs as representatives of minority shareholders becomes extremely important.

We would like to see an additional requirement that one of the INEDs be appointed as a senior independent director (SID) with an appropriate definition along the lines of:

- ▶ Presiding at all meetings of the board at which the chairman is not present, including sessions of the independent directors;
- ▶ Calling meetings of the independent directors;
- ▶ Serving as the principal liaison on board-wide issues between the independent directors and the chairman;
- ▶ Approving the quality, appropriateness and timeliness of information sent to the board as well as approving meeting agenda items;
- ▶ Facilitating the board's approval of the frequency of board meetings, as well as meeting schedules to assure that there is sufficient time for discussion of all agenda items;
- ▶ Retaining outside advisors and consultants who report directly to the board of directors on board-wide issues;

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- ▶ Ensuring he/she be available, if requested by shareholders, when appropriate, for consultation and direct communication;
- ▶ He/she should agree to and document the split roles between a non-independent chairman, the CEO and the senior independent director and have this published on the company's website so that shareholders can understand the break out of responsibilities.

PART4: DIVIDEND POLICY

14. Do you agree with our proposal to introduce CP E.1.5 requiring (on a “comply or explain” basis) the issuer to disclose its dividend policy in the annual report?

- Yes
 No

Please give reasons for your views.

We believe this should be made into the Listing Rules.

PART5: ELECTRONIC DISSEMINATION OF CORPORATE COMMUNICATIONS – IMPLIED CONSENT

15. Do you think that the Rules should be amended to allow shareholders' consent to be implied for electronic dissemination of corporate communications by issuers?

- Yes
 No

Please give reasons for your views.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Concept Paper on Capital Raising by Listed Issuers and will continue to work with HKEX on any specific issues which may assist in the discussion of weighted voting rights.