

Via E-Mail

December 8, 2017

Corporate Communications Department  
Hong Kong Exchanges and Clearing Limited  
12<sup>th</sup> Floor, One International Finance Centre  
1 Harbor View Street  
Central  
Hong Kong

*Re: Consultation Paper on Review of the Corporate Governance Code and Related Listing Rules<sup>1</sup>*

Dear Sirs/Madams:

I am writing in response to the Stock Exchange of Hong Kong Limited (Exchange) Consultation Paper entitled “Review of the Corporate Governance Code and Related Listing Rules” (Paper). The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding \$3 trillion.

Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$20 trillion in assets under management.<sup>2</sup>

As the leading voice of corporate governance in the United States, we support the Exchange’s efforts to ensure that the Corporate Governance Code and Corporate Governance Report and the related amendments to the Rules Governing the Listing of Securities “reflect currently acceptable standards and are adequate for maintaining investors’ confidence in the market.”<sup>3</sup>

We offer the following specific comments in response to certain of the questions posed by the Paper.

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<sup>1</sup> HKEX, Consultation Paper, Review of the Corporate Governance Code and Related Listing Rules (Nov. 2017), <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>.

<sup>2</sup> For more information about the Council of Institutional Investors (“CII”), including its members, please visit the CII’s website at <http://www.cii.org/members>.

<sup>3</sup> Consultation Paper at 1.

*Question 1: Do you agree with our proposed amendment to CP A.5.5 as described in paragraph 36. Please give reasons for your views.*<sup>4</sup>

CII generally agrees with the proposed amendment to CP A.5.5 as described in paragraph 36. We, however, would revise the amendment to replace “seventh” with “fifth.”<sup>5</sup> The amendment as revised would be generally consistent with our membership approved policies that state:

Companies should establish and publish guidelines specifying on how many other boards their directors may serve. Absent unusual, specified circumstances, directors with full-time jobs should not serve on more than two other boards. Currently serving CEOs should not serve as a director of more than one other company, and then only if the CEO's own company is in the top half of its peer group. No other director should serve on more than five for-profit company boards.<sup>6</sup>

We note that a recent survey by Institutional Shareholder Services (ISS) indicates that many institutional investors favor overboarding policies more restrictive than CII policies.<sup>7</sup> Results of the ISS survey included:

Survey respondents were asked whether the “overboarding” standard which should apply to an executive chairman who is not also the company’s CEO should be the same standard as that applied to a sitting CEO (no more than three total boards) or the standard applied to a non-executive director (no more than five total boards in 2017). Among investors, 64 percent of respondents favored the tighter overboarding standard applied to CEOs . . . .”<sup>8</sup>

Similarly, a recent academic paper demonstrates that over commitment by directors can cause a host of significant problems for corporations.<sup>9</sup> The paper describes over commitment as occurring when independent directors serve on more than three public boards.<sup>10</sup>

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<sup>4</sup> *Id.* at 8.

<sup>5</sup> *Id.* at 7.

<sup>6</sup> Council of Institutional Investors, Corporate Governance Policies, § 2.11 Board Size and Service (updated Sept. 15, 2017), [http://www.cii.org/files/policies/09\\_15\\_17\\_corp\\_gov\\_policies.pdf](http://www.cii.org/files/policies/09_15_17_corp_gov_policies.pdf).

<sup>7</sup> ISS, “Majority of Investors Favor Tighter ‘Overboarding’ Standards for U.S. Executive Chairs and Adverse Director Recommendations in Wake of Dual-Class IPOs” 1 (Sept. 29, 2017), <https://www.issgovernance.com/iss-announces-results-annual-benchmark-voting-policy-survey/>.

<sup>8</sup> *Id.*

<sup>9</sup> Jeremy C. Kress, “Board to Death: How Busy Directors Could Cause the Next Financial Crisis” 41-42 (Steven M. Ross Sch. of Bus., Univ. Mich., Working Paper No. 1370, 2017) (“Preserving the safety and soundness of the financial system, therefore, requires that financial company directors—and especially those with key board leadership positions—reduce their outside commitments”), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2991142](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2991142).

<sup>10</sup> *Id.* at 33.

*Question 2: Do you agree with our proposals to upgrade CP A.5.6 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? Please give reasons for your views.*

*Question 3: Do you agree with our proposal to amend CP A.5.5 that it requires 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. Please give reasons for your views.*

*Question 4: Do you agree with our proposal to amend Mandatory Disclosure Requirement L.(d)(ii) as described in paragraph 56? Please give reasons for your views.*<sup>11</sup>

CII generally agrees with all of the Paper's proposals relating to board diversity. Our membership approved policy supports a diverse board.<sup>12</sup> More specifically, our policy states:

CII believes a diverse board has benefits that can enhance corporate financial performance, particularly in today's global market place. Nominating committee charters, or equivalent, ought to reflect that boards should be diverse, including such considerations as background, experience, age, race, gender, ethnicity, and culture.<sup>13</sup>

As indicated in the Paper,<sup>14</sup> the proposed changes and our policy are supported by the growing body of studies that "shows that companies with more diverse leadership teams perform better financially."<sup>15</sup>

*Question 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 advisers before they can be considered independent, instead of the current one year? Please give reasons for your views.*<sup>16</sup>

CII generally agrees with the proposal to revise Rule 3.13(3) so that there is a three-year cooling off period for professional advisers before they can be considered independent. We believe independence is critical to a properly functioning board.

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<sup>11</sup> Consultation Paper at 10.

<sup>12</sup> § 2.8b Board Diversity.

<sup>13</sup> *Id.*

<sup>14</sup> Consultation Paper at 9.

<sup>15</sup> Alina Tugend, "Melody Hobson Says the Time for Corporate Diversity is Now," DealBook/Business & Policy, N.Y. Times, Nov. 14, 2017, at 2, <https://www.nytimes.com/2017/11/14/business/dealbook/melody-hobson-corporate-diversity.html>; see Deloitte, "US Boards: The Last Mile to Achieving Corporate Diversity, Deloitte Survey Finds" 1 (Dec. 5, 2017) ("near unanimous agreement among survey respondents . . . that diverse perspectives and experiences provide a competitive advantage to improving business performance"), <https://www.prnewswire.com/news-releases/us-boards-the-last-mile-to-achieving-corporate-diversity-deloitte-survey-finds-300565069.html>.

<sup>16</sup> Consultation Paper at 13.

We note that CII policies generally support a five year cooling off period for establishing director independence.<sup>17</sup> However, we acknowledge that Australia, the United Kingdom, and the United States all currently have a “cooling off period of three years for professional advisers.”<sup>18</sup> While we continue to believe a five year cooling off period would be preferable, we commend the Exchange for moving forward to at least match the existing practices in those jurisdictions.

*Question 6: Do you agree with our proposal to revise CP C.3.2 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? Please give reasons for your views.*<sup>19</sup>

CII generally agrees with the proposal to revise CP C.3.2 so that there is a three-year cooling off period for a former partner of the issuer’s existing audit firm before he or she can be a member of the issuer’s audit committee. As we indicated in response to question 5, while CII policy generally supports a five year cooling off period for establishing director independence, we again commend the Exchange for pursuing this improvement in the independence of directors.

*Question 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? Please give reasons for your views.*<sup>20</sup>

CII believes directors with material interests in the issuer’s principal business may in some cases have very valuable insights to provide to the board. However, regardless of that contribution, they should not be considered independent.

We also support the Exchange taking into account a proposed INED’s current as well as recent material interests in the issuer’s principal business activities. Finally, as indicated in response to questions 5 and 6, we would also support the Exchange adopting up to a five-year cooling off period for determining whether a board member should be considered independent.<sup>21</sup>

*Question 8: Do you agree with our proposal to introduce a new RBP A.3.3 to recommend disclosure of INEDs’ cross-directorships or having significant links with other*

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<sup>17</sup> For example, Section 7.3d of CII’s member-approved policies states a director will not be considered independent if he or she:

Has, or in the past five years has had, or whose relative has paid or received more than \$50,000 in the past five years under, a personal contract with the corporation, an executive officer or any affiliate of the corporation . . . .”

<sup>18</sup> Consultation Paper at 12.

<sup>19</sup> *Id.* at 13.

<sup>20</sup> *Id.* at 14.

<sup>21</sup> Section 7.3c of CII’s member-approved policies states a director will not be considered independent if he or she:

Is, or in the past five years has been, or whose relative is, or in the past five years has been, employed by or has had a five percent or greater ownership interest in a third-party that provides payments to or receives payments from the corporation and either: (i) such payments account for one percent of the third-party’s or one percent of the corporation’s consolidated gross revenues in any single fiscal year; or (ii) if the third-party is a debtor or creditor of the corporation and the amount owed exceeds one percent of the corporation’s or third party’s assets.

*directors through involvements in other companies or bodies in the Corporate Governance Report? Please give reasons for your views.*<sup>22</sup>

CII opposes interlocking directorships and supports the Exchange recommending disclosure of cross-directorships or significant links with other directors through involvement in other companies or bodies. Furthermore, we encourage requiring such disclosure and would even support denying independent status to board nominees and incumbent directors who are part of, or who have been part of in the last five years, an interlocking directorship.<sup>23</sup>

*Question 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? Please give reasons for your views.*<sup>24</sup>

Although we appreciate the addition of the consideration of an INED's immediate family in the assessment of a director's independence, we believe the immediate family does not sufficiently capture the full breadth of relatives who should be considered as part of the assessment of independence.

CII's member-approved policies on director independence cover a broader definition of relatives that includes "spouses, parents, children, step-children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, aunts, uncles, nieces, nephews and first cousins, and anyone sharing the director's home."<sup>25</sup>

*Question 10: Do you agree with our proposal to adopt the same definition for "immediate family member" as Rule 14A.12(1)(a) as set out in paragraph 81? Please give reasons for your views.*<sup>26</sup>

As with Rule 3.31, CII encourages the Exchange to apply a broader definition of relatives covering those described in "spouses, parents, children, step-children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, aunts, uncles, nieces, nephews and first cousins, and anyone sharing the director's home."<sup>27</sup>

*Question 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? Please give reasons for your views.*<sup>28</sup>

CII generally agrees with the Exchange's proposal to state that the issuer should disclose its nomination policy adopted during the year, which sets out the board's consideration of the balance of skills, experience and diversity of perspectives appropriate to the requirements of the

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<sup>22</sup> Consultation Paper at 15.

<sup>23</sup> Section 7.3f of CII's member-approved policies states a director will not be considered independent if he or she: Is, or in the past five years has been, or whose relative is, or in the past five years has been, part of an interlocking directorate in which the CEO or other employee of the corporation serves on the board of a third-party entity (for-profit or not-for-profit) employing the director or such relative; . . .

<sup>24</sup> Consultation Paper at 16.

<sup>25</sup> § 7.3a.

<sup>26</sup> Consultation Paper at 16.

<sup>27</sup> § 7.3a.

<sup>28</sup> Consultation Paper at 16.

issuer's business. Such disclosure aligns with the perspective expressed in CII's member-approved policies, which state the board should disclose a board succession plan, establish clear procedures, and recruit varied skills and backgrounds that complement one another.<sup>29</sup>

*Question 12: Do you agree with our proposal to amend CP A.6.7 by removing the last sentence of the current wording? Please give reasons for your views.*<sup>30</sup>

Directors benefit from attending shareholder meetings, and CII's member-approved policies state that all board members, whether independent or not independent, should not only attend the annual shareowners' meeting, but also be available, if requested by the chair, to respond directly to oral and written questions from shareowners.<sup>31</sup> We therefore oppose the proposed deletion of the last sentence of CP A.6.7, which currently provides that all directors should attend general meetings and develop a balanced understanding of the views of shareholders.

*Question 13: Do you agree with our proposal to revise CP A.2.7 to state that INEDs should meet at least annually with the chairman? Please give reasons for your views.*<sup>32</sup>

CII supports periodic "executive sessions" without any executives present. (If the chair is an employee chair, such session should be led by a lead independent director.) Section 2.12c of CII's member-approved policies states that "independent directors should hold regularly scheduled executive sessions without any of the management team or its staff present."<sup>33</sup>

*Question 14: Do you agree with our proposal to introduce CP E.1.5 requiring the issuer to disclose its dividend policy in the annual report? Please give reasons for your views.*<sup>34</sup>

Though CII does not have an explicit policy on dividend policy transparency, we are sympathetic to the proposal to require disclosure, as doing so would align with requirements existing in many markets throughout the world.<sup>35</sup>

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<sup>29</sup> CII's member-approved policies states:

2.8a Board Succession Planning: The board should implement and disclose a board succession plan that involves preparing for future board retirements, committee assignment rotations, committee chair nominations and overall implementation of the company's long-term business plan. Boards should establish clear procedures to encourage and consider board nomination suggestions from long-term shareowners. The board should respond positively to shareowner requests seeking to discuss incumbent and potential directors.

<sup>30</sup> Consultation Paper at 17.

<sup>31</sup> § 4.8 Director Attendance.

<sup>32</sup> Consultation Paper at 18.

<sup>33</sup> § 2.12c Executive Sessions.

<sup>34</sup> Consultation Paper at 19.

<sup>35</sup> *Id.*

Thank you for consideration of our views. If we can answer any questions or provide additional information, please do not hesitate to contact me at 202.822.0800 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,

A handwritten signature in black ink that reads "Jeff Mahoney". The signature is written in a cursive, flowing style.

Jeffrey P. Mahoney  
General Counsel