An evolutionary approach to Corporate Governance reform

Reflections on the HKEX final Corporate Governance Code enhancements

By CFA Society Hong Kong and CFA Institute

4 February 2025

The Hong Kong Exchanges and Clearing Limited (HKEX or the Exchange) has recently finalized enhancements to the Corporate Governance Code and related Listing Rules. These revisions follow a consultation launched in August of last year, during which the Exchange has garnered 261 responses from a diverse array of stakeholders. Among the respondents, 66 (25%) were listed issuers, while only 15 (6%) represented investment management firms. The remainder comprised professional bodies. industry associations and law firms. This highlights the significant influence of issuers in shaping the final proposals.

The primary objectives of the reform were to enhance board effectiveness, independence, and diversity, while also improving issuers' disclosures on risk management and internal controls. Notably, the focus on board effectiveness and Independent Non-Executive Directors (INEDs) as guardians of corporate governance has been the subject of discussion over the years.

CFA Society Hong Kong and CFA Institute, representing our global membership, of which 6,000 are based in Hong Kong, responded jointly to the Consultation. In this article, we provide an overview of the Exchange's final corporate governance enhancements, explore their potential implications, and share our perspectives on the reform.

Key Changes and Reflections

1. A soft approach to Lead INEDs

Initially, the Exchange proposed a new Code Provision (i.e., on a comply-or-explain basis) that would require issuers without an independent board chair to designate one INED as a Lead Independent Non-Executive Director (Lead INED). The proposal, however, faced pushback with 41% of respondents opposing it. As a result, the designation of a Lead INED has been modified to a voluntary framework, now positioned as a Recommended Best Practice (i.e., on a voluntary basis). Consequently, companies will not be bound by the "comply-or-explain" requirement – although the Exchange encourages issuers without an independent board chair designate a Lead INED to act as a bridge between shareholders and the board. Meanwhile, issuers are required to disclose their engagement with shareholders, which is a Code Provision.

2. A prolonged and gradual farewell to long-serving INEDs

Under the New Rule, an issuer's board must not include an INED who has served over nine years, known as a Long Serving INED. The cooling-off period for these individuals will be extended from two to three years, aligning with our suggestions to the Exchange and common practices in several APAC markets, such as Singapore, Australia, Malaysia, and India.

This rule will be implemented in a phased manner over an extended six-year transition period, rather than the initially proposed three years, signaling a prolonged departure for long-serving INEDs.

(i) Phase one (compliance by the first AGM held on or after 1 July 2028) – No Long Serving INEDs may represent a majority of the INEDs.
(ii) Phase two (compliance by the first AGM held on or after 1 July 2031) – No Long Serving INEDs may be on the board.

3. Evolutionary steps to advance director training

First-time directors are required to complete a minimum of 24 hours of training within the first 18 months of appointment as a New Rule, with a reduced requirement of 12 hours for those with listed issuer directorship experience on other exchanges within three years prior to their appointment. In particular, topics that are fundamental to the objectives of director training, such as regulatory and legal responsibilities of boards and directors, should be prioritized. This approach aligns with our recommendations, where we indicated that courses should cover relevant legal and regulatory framework to ensure directors understand governance complexities and their responsibilities from the outset.

4. Enhanced framework for board accountability

Elevated from a Recommended Best Practice to a Code Provision, issuers are now required to conduct board performance reviews every two years, with the results disclosed in governance reports. The Exchange has clarified that the focus should be on the overall performance of the board and its alignment with the issuer's broader strategic goals.

At the same time, under the New Code Provision, issuers must maintain a board skills matrix and make specific disclosure in their Corporate Governance Report. The matrix should outline board competencies and identify any gaps. We have suggested the Exchange define essential competencies in the matrix, such as: financial expertise, ESG knowledge and industry insights. In the Exchange's New CG Guide, suggestions as to the format, scope and level of detail for maintaining an effective board skills matrix and making meaningful disclosure would be provided.

Other noteworthy advancements

Overboarding INED and directors' time commitment (New Rule and Mandatory Disclosure Requirement)	There will be a cap on "overboarding," stating that INEDs must not concurrently hold more than six directorships in Hong Kong-listed issuers, with a three-year transition period for compliance (New Rule). The new Mandatory Disclosure Requirement will include additional disclosure requirements in relation to the nomination committee's annual assessment of the time commitment and board contribution of each director.
Board and workforce diversity	Three measures are introduced regarding diversity: (i) the nomination committee to comprise directors of different genders (New Code Provision); (ii) annual reviews of board diversity policy (Upgrade to Mandatory Disclosure Requirement); and (iii) a workforce diversity policy (New Rule).

Risk management and internal control (Upgraded to Mandatory Disclosure Requirement)	The board will be responsible for overseeing the issuer's risk management and internal controls, including conducting annual reviews of the effectiveness of risk management and internal control systems.
Capital management (New Mandatory Disclosure Requirement)	Disclosure of the issuer's policy on payment of dividends and the board's dividend decisions during the reporting period will be required.

Conclusion

We view the Exchange's enhancement of the Corporate Governance Code and related Listing Rules as a significant move towards a modernized framework for corporate governance. This presents a great opportunity to articulate aspirations and deliver strong market signals on this important topic. While we laud the Exchange for taking such a bold step, we have noted a more accommodating approach to lead INEDs and long-serving INEDs as compared to the initial proposal. We believe this shift reflects challenges from issuers, which constitute the majority of respondents in the consultation process, on their state of readiness relating to the proposed changes.

Capital formation has encountered challenges recently, and the reform is placing significant demands on issuers, as reflected by the primary feedback received among listed issuers. Given the distinctive characteristics of Hong Kong's capital market— such as its evolving investor dynamics and family-controlled shareholding structures — issuers believed that the previous regime had already offered sufficient investor protection, and that this is not the most opportune juncture for sweeping reforms.

Looking ahead, we hope to see bolder initiatives from the Exchange, as there remains significant potential for enhancements in various areas. For instance, further empowering Lead INEDs in discharging their duties effectively. Importantly, for Hong Kong to lead in corporate governance standards, INEDs could serve as a gatekeeper to facilitate and oversee meaningful shareholder engagement. In addition, regular reviews are crucial for identifying governance gaps. We believe that implementing annual reviews would enable issuers to address governance gaps more promptly. Developing an action plan in response to these gaps is also essential for fostering effective governance.

Despite the implementation challenges that lie ahead, the promise of enduring benefits underscores the importance of the initiative. Empowered INEDs, combined with enhanced independence and transparency, and inclusive leadership, can collectively establish a governance framework that fosters trust, mitigates risks, and promotes sustainable growth. This reform not only reinforces Hong Kong's standing as a leading financial hub but also bolsters its appeal as a robust capital market, facilitating capital raising and investment opportunities.

CFA Society Hong Kong and CFA Institute remain committed to supporting investors and members as they navigate these changes, advocating for governance frameworks that prioritize empowerment, transparency, and accountability. Together, we can cultivate a governance landscape that not only addresses today's demands but also lays the groundwork for future progress.

For inquiries, please contact CFA Society Hong Kong or CFA Institute.

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