

BEYOND DISCLOSURE – THE EMERGENCE OF ESG AS A C-SUITE RISK FACTOR**PART III*: HONG KONG RACES AHEAD WITH FURTHER ESG ENHANCEMENTS RELATING TO BOARD INDEPENDENCE, DIVERSITY AND OTHER ISSUES**

On 16 April 2021, the Stock Exchange of Hong Kong Limited (“HKEX”) issued a consultation paper seeking public comment on proposed enhancements to its existing Environmental, Social and Governance (“ESG”) disclosure requirements for listed companies and IPO applicants (the “Consultation”).¹ The Consultation is the latest in a series of amendments to HKEX listing and disclosure standards over recent years.² The period for public comment will remain in effect until June 18, 2021. HKEX has included ESG disclosure provisions in its Listing Rules since 2012. The Consultation seeks further alignment of HKEX’s existing regime with the ESG trends that are emerging in other leading financial hubs. The key issues raised in the Consultation relate to:

(1) **Corporate culture**

HKEX proposes that listed companies be required to align their culture with their purposes, values and strategies. To this end, HKSE will provide guidance to: (a) explain the board’s role in “culture;” (b) set out key elements commonly identified in a sound culture; and (c) recommend key issues which may be helpful to stakeholders to understand the company’s culture³. In addition, there will be requirements to establish an anti-corruption policy and a whistleblowing policy and these requirements will also be subject to “comply or explain” disclosure requirements⁴.

* FisherBroyles is providing this alert as part of a series on ESG and its emergence as a risk factor for the C-Suite and legal, compliance, and risk professionals. This part of the series focuses on recent ESG disclosure developments in the Hong Kong Stock Exchange. The first and second part of the series can be found [here](#) and [here](#).

¹ Review of Corporate Governance Code and Related Listing Rules, The Stock Exchange of Hong Kong Limited (April 2021).

² See Appendix 27, The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (July 2020); Review of the Corporate Governance Code and Related Listing Rules (November 2017); Review of the Environmental, Social and Governance Reporting Guide and Related Listing Rules (May 2019).

³ Paragraph 16, Supra note 3

⁴ Paragraph 59, Supra note 3

(2) **Board independence, refreshment and succession planning**

The HKEX has a relatively high concentration of companies with boards that could be considered insufficiently independent. This is due to a number of factors, the most obvious of which is the dominance of family-controlled and Chinese State-owned enterprises listed on HKEX. In order to enhance board independence, HKEX has proposed requiring (i) a policy to ensure that independent views are available to the board and (ii) that such policy is subject to regular reviews for its implementation and effectiveness.⁵ There have also been proposals to promote succession planning whereby long serving independent non-executive directors (“INEDs”) of over 9 years tenure are required to be re-elected and be subject to independent shareholders approvals and a requirement to disclose the factors that were considered in approving such re-election.⁶

(3) **Diversity and nomination**

According to an MSCI report, in 2020 only 12.7% of Hong Kong listed companies’ directorships was held by women, compared to 12.4% in 2019. As of 31 December 2020, out of 2,538 issuers, around 32.1% had no female directors on their boards, whilst around 37.4% had only one female director.⁷ To further enhance gender diversity, HKEX has proposed provisions to specifically highlight that single gender boards are not considered diverse and to require that companies establish numerical targets and timelines for achieving gender diversity at both board level and across the workforce. A 3-year transition period will be granted to ensure transition to achieving at least one director of the absent gender.⁸ HKEX also proposes that relevant diversity information relating to companies is disclosed on the HKEX website.⁹ Furthermore, where a company has a nomination committee, such committee should be chaired by an INED and comprise a majority of INEDs.¹⁰

(4) **Shareholder communication policy**

In order to achieve effective two-way communication between issuers and shareholders, HKEX will require mandatory disclosure of a company’s shareholder communication policy which must include channels for shareholders to communicate their views on various matters impacting the company and steps to consider the views of shareholders and stakeholders. Companies will also be required to review the effectiveness of

⁵ Paragraph 60, Supra note 3

⁶ Paragraph 73, Supra note 3

⁷ MSCI’s [“Women on Boards: 2020 Progress Report”](https://www.msci.com/documents/10199/9ab8ea98-25fd-e843-c9e9-08f0d179bb85) <https://www.msci.com/documents/10199/9ab8ea98-25fd-e843-c9e9-08f0d179bb85>.

⁸ Paragraph 25, Supra note 3

⁹ Paragraph 88, Supra note 3

¹⁰ Paragraph 90, Supra note 3

the policy on an annual basis.¹¹ To date, such disclosure of an issuer's communication policy has been voluntary.

(5) **Significance of the Consultation**

ESG disclosure is not a new feature of HKEX's Listing Rules. The Consultation demonstrates HKEX's continued leadership amongst the major Asia-Pacific stock exchanges in terms of its commitment to ESG. While ESG developments are taking place across key European and North American markets, Asia is also exhibiting an increased commitment to this global trend. For companies dual-listed in Mainland China and in Hong Kong, the Hong Kong ESG disclosure requirements will continue to sit as an additional layer of disclosure separate from what is required for A-Share listings in Mainland China. In addition, given HKEX's role as a gateway for bidirectional access between Mainland Chinese companies and international investors, the enhancement of ESG disclosures covered by the Consultation is likely to be welcomed by international and institutional investors seeking to identify companies that exhibit a commitment to sustainability and ESG.

Current and potential HKEX issuers should evaluate their corporate governance policies and processes in relation to the Consultation. In particular, issuers should consider the following initiatives:

- Articulate the issuer's statement on corporate culture and evaluate the alignment of its culture with its purposes, values and strategies. Anti-corruption and whistle-blower policies should be formulated and enacted to the extent such policies do not already exist. The board should take an active and leading role in establishing the issuer's culture.
- Begin immediately identifying pools of independent directors for eventual board succession, particularly directors with competence in ESG-related governance. The boards of a significant number of issuers in Hong Kong will not meet the necessary independence requirements in the medium term and should consider succession issues early as the introduction of appropriately qualified and suitable board members into a company takes time and will incur expenses, thereby adding to existing operational burdens.
- Begin proactively identifying potential gender-diverse candidates for positions on the board and in management. For many issuers, gender diversity will be an issue that involves considerable "catching up" and similar to the challenges relating to board independence, issuers should act early and start promoting the necessary talent internally well in advance in order to achieve the necessary diversity within the transitional period.

¹¹ Paragraph 96, *Supra* note 3

- To the extent needed, prepare a shareholder communication policy that provides avenues of engagement with shareholders and allows for substantive shareholder feedback. If a policy already exists, critically review its channels of communication and overall effectiveness, taking into account the size, scale, operations and reputation of the company.

FisherBroyles will continue to report on important developments concerning ESG matters and their potential effects on publicly traded companies, capital markets and other industries likely to be affected. We are able to advise and assist you with SEC disclosure matters as well as both proactive efforts to build and maintain a risk and/or compliance program, as well as responding to regulatory inquiries and enforcement matters.

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