Proactive Governance: Shaping Hong Kong's Boards of Tomorrow

Insights for nominating committees on board performance, succession planning, and diversity in Hong Kong's evolving governance landscape.

On June 14, 2024, the Hong Kong Stock Exchange (HKEx) released a consultation paper seeking views and comments on proposed changes to the Corporate Governance code and related amendments to the HKEx Listing Rules. Among the proposed changes were several specific to how boards and their nominating committees need to reevaluate their performance, succession-planning, and renewal.

Among the proposed changes are specific limits around tenure, overboarding, independence, and board diversity, including:

1. Board directors serving more than nine years will no longer be considered independent
2. Directors will be limited to a maximum of six publicly-listed boards
3. Boards must designate a lead independent director (LID) if they do not have an independent chair *(comply or explain)*
4. Nominating committees must be comprised of directors of different genders, with a minimum of one director of a different gender *(comply or explain)*

Additionally, there are other mandatory disclosure requirements on director training, the board's annual review of its workforce diversity, and women's representation within senior management.

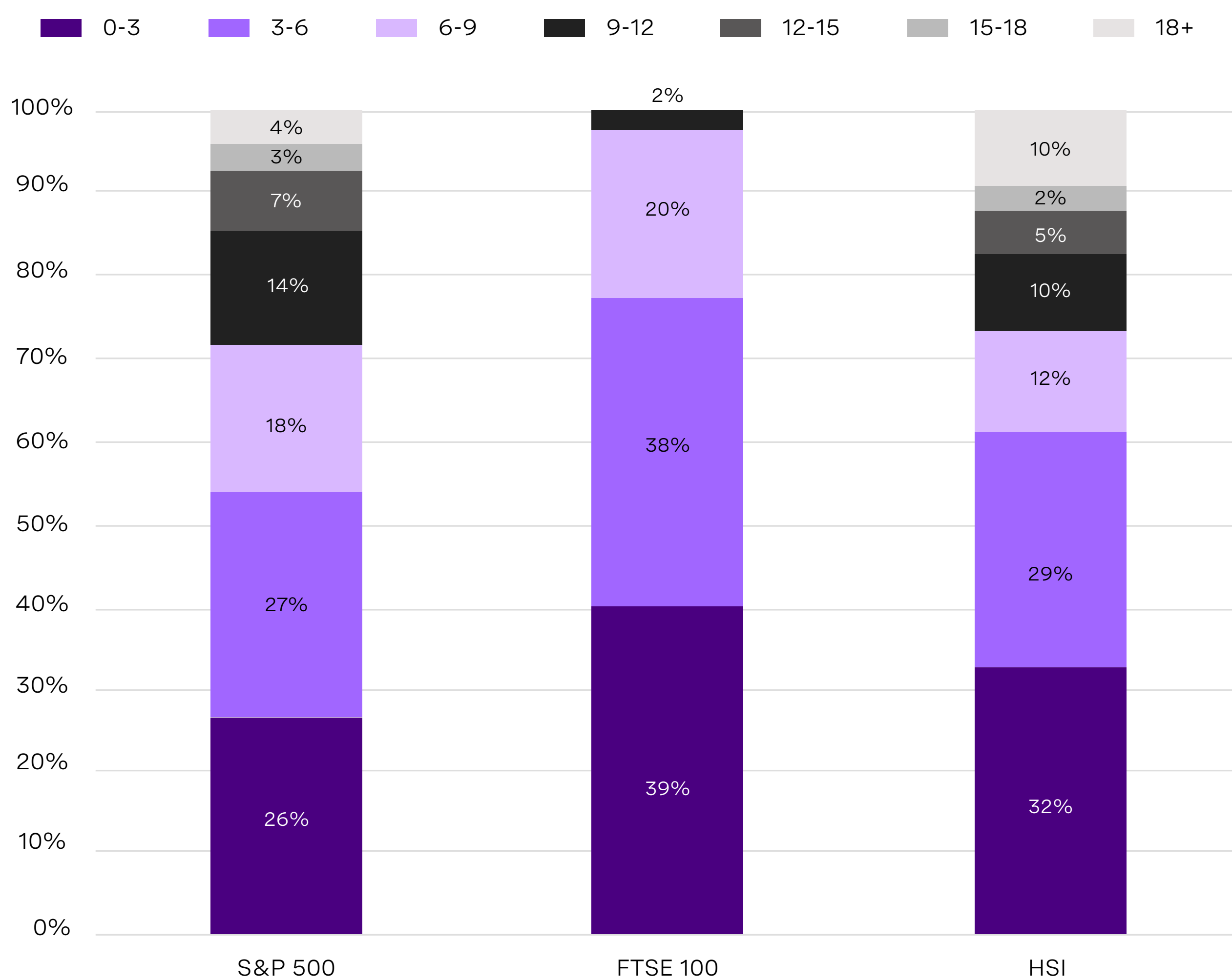
To help Hong Kong's publicly-listed boards prepare for the future, Russell Reynolds Associates compared the Hang Seng Index (HSI) to other major global indices to understand why the changes are necessary, and how publicly listed boards can better cope with what's coming next.

Tenure caps will impact over one-third of Hong Kong's boards

One of the proposed corporate governance updates that could significantly impact board composition in Hong Kong: the nine-year tenure cap for independent directors.

Our analysis shows that 27% of INEDs on the HSI have served for over nine years. Current rules require that independent directors constitute at least one-third of the board, meaning boards at this threshold risk non-compliance if their long-serving independent non-executive directors (INEDs) are no longer deemed independent. In contrast, FTSE 100 boards regularly refresh their composition, with 98% of INEDs serving nine years or less (Figure 1). And while it may seem that boards on the HSI share a similar tenure distributions with those of the S&P 500, it needs to be viewed in the context that the Nasdaq and NYSE generally require boards to comprise a majority of independent directors.

Figure 1: Tenure distribution of INEDs across the S&P 500, FTSE 100, and HSI



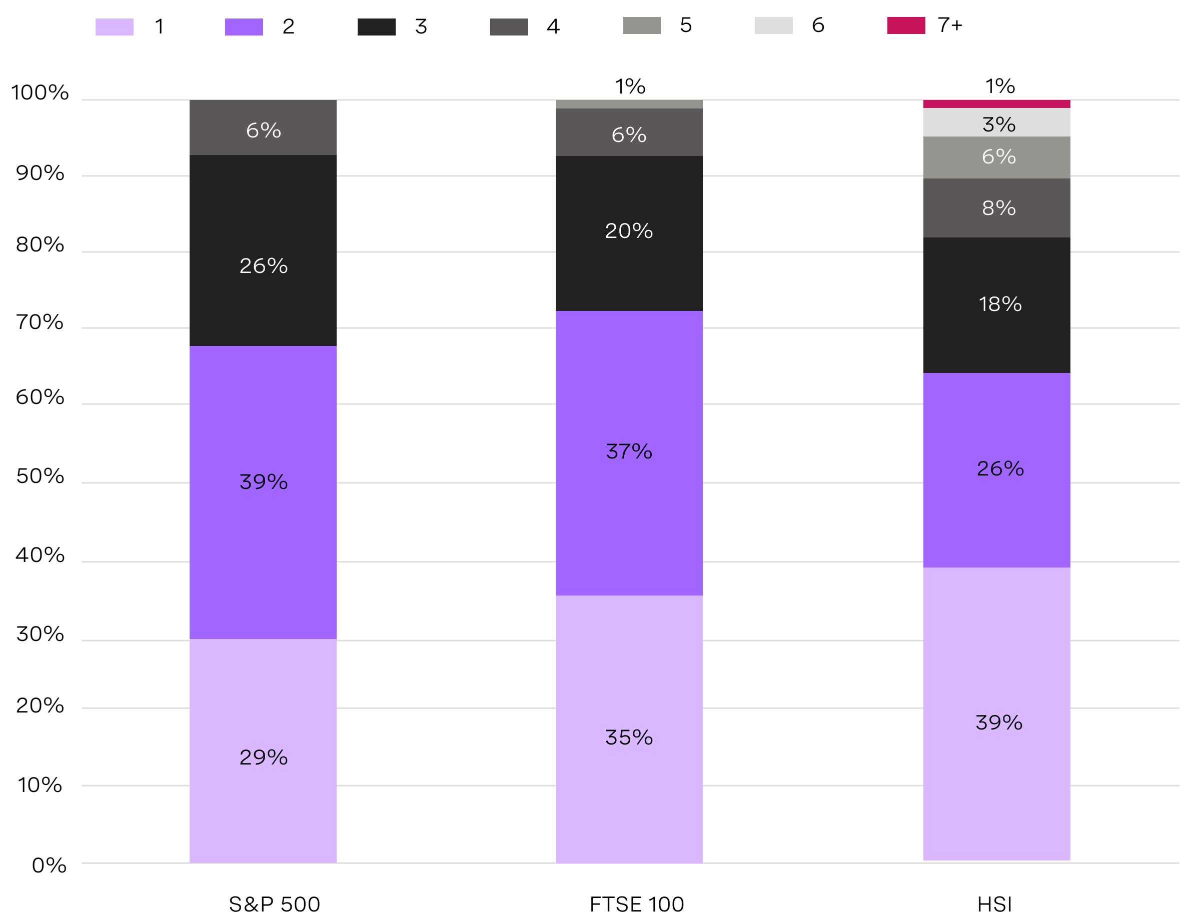
Source: RRA analysis of BoardEx data, collected in October 2024. n = 4699 S&P 500 INEDs; n = 773 FTSE 100 INEDs; n = 416 HSI INEDs.

Overboarding limits: a cause for concern?

The next proposed change—to limit the maximum number of listed boards directors can sit on to six—has attracted a fair bit of commentary and pushback amongst the community. One compelling argument is that directors have varying time commitments, and that imposing a cap like this is too simplistic. In short, many believe that decisions on director's bandwidth should be left to the nominating committees.

In examining the S&P 500 and FTSE 100, we see that over 90% of INEDs sit on three or less public boards (Figure 2). And in Hong Kong, only four out of 82 HSI boards have directors who sit on more than six boards—and three of said directors are currently at that one-third INED threshold.

Figure 2: Number of concurrent public board seats an INED has across the S&P 500, FTSE 100, and HSI



Source: RRA analysis of BoardEx data, collected in October 2024. n = 4699 S&P 500 INEDs; n = 773 FTSE 100 INEDs; n = 416 HSI INEDs.

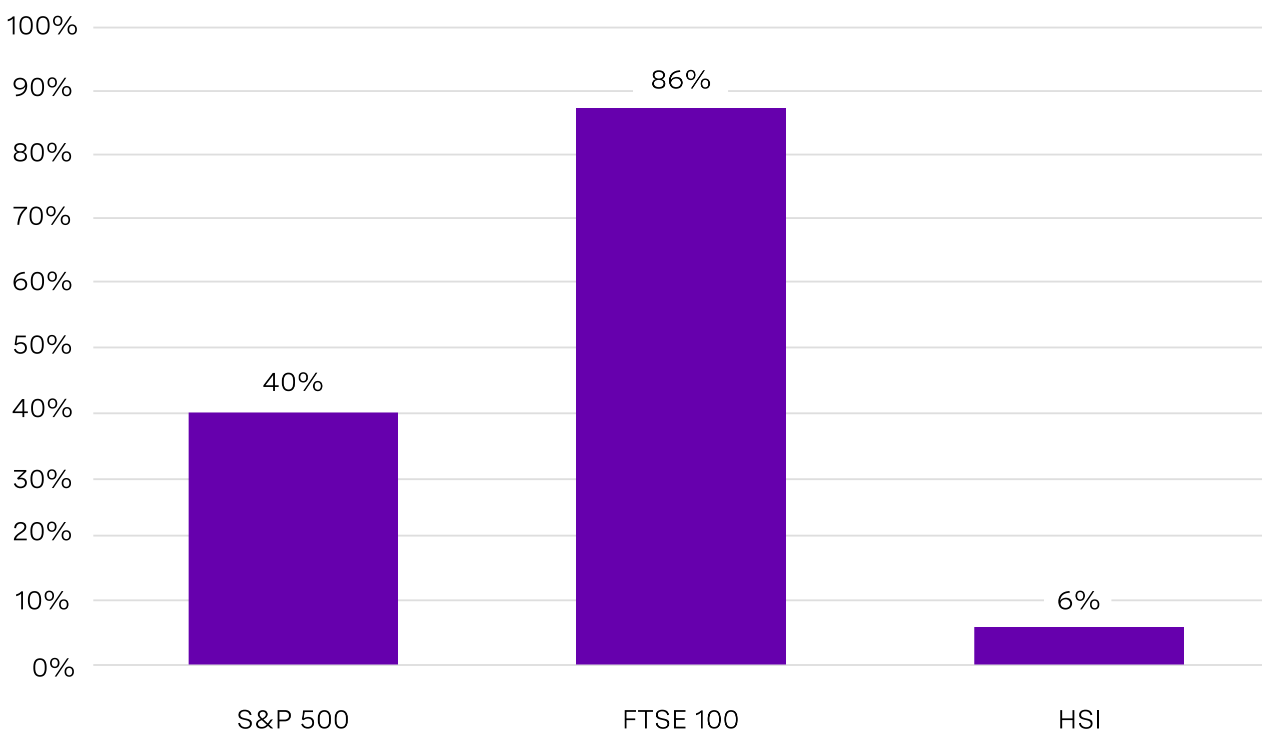
Given the increasingly complex business environment over the years, the reality is that boards today do require more of a director's bandwidth. With all these in mind, we view the cap of six boards per director as reasonable.

Hong Kong is aligning with other OECD countries in LID appointment proposal

Another significant proposal involves the designation of a lead independent director (LID) for boards whose chairs are non-independent. This move is a step to directionally align Hong Kong with many OECD countries—like the United Kingdom, Germany, Netherlands, Norway, and Sweden—where board chairs are typically independent, negating the need to appoint a separate independent director (Figure 3).

As only 6% of HSI boards have an independent chair, it's likely that this proposal will have a significant impact on HKEx-listed boards in general.

Figure 3: Percentage of boards that have an independent chair across the S&P 500, FTSE 100, and HSI



Source: RRA analysis of BoardEx data, collected in October 2024. n = 500 S&P 500 boards; n = 100 FTSE 100 boards; n = 82 HSI boards.

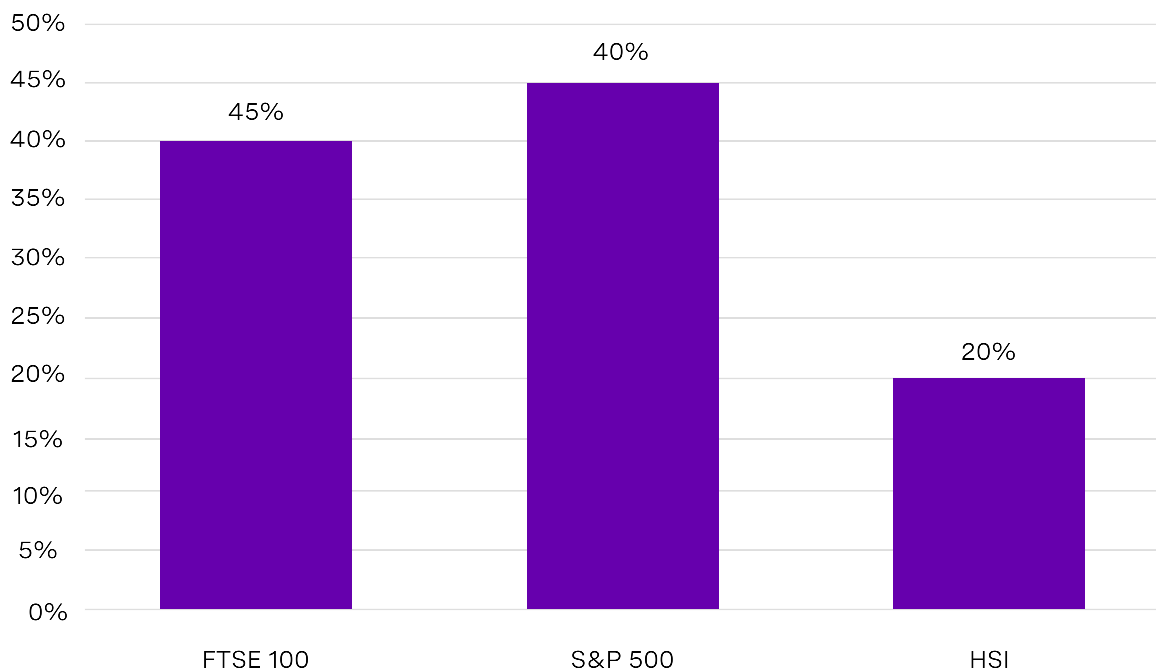
Proposals will further improve nominating committee diversity in Hong Kong

While there has been recent progress when it comes to board diversity, Hong Kong boards still have a long way to go before reaching gender parity. Currently, 40% of HSI boards' nominating committees are composed only of men. We also found women directors hold only 20% of the HSI's nominating committee seats, compared to women holding 48% in the FTSE 100 and 40% in the S&P 500 (Figure 4).

According to the Institute of Directors (IoD), markets with binding quotas have seen the most significant advancements towards gender parity over the past two decades. For instance, women's representation in FTSE 100 increased from 12.5% in 2012 to 40% by 2022, according to the UK Government.

As such, the proposals to 1) implement a gender-diverse nominating committee on a comply or explain basis and to 2) mandate disclosures of board diversity policies presents a major step towards gender parity in the HSI.

Figure 4: % of women directors holding nominating committee seats across the S&P 500, FTSE 100, and HSI



Source: RRA analysis of BoardEx data, collected in October 2024. n= 1600 S&P 500 nominating committee seats; n = 583 FTSE 100 nominating committee seats; n = 328 HSI nominating committee seats.

Looking inward: HSI boards will increase focus on their effectiveness and skillsets

The final set of proposals centers on enhancing board effectiveness and upskilling.

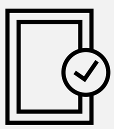
Implementing a board skills matrix is a logical first step, as it clearly outlines the critical expertise and experiences necessary for the board's effective functioning.

This matrix not only informs shareholders and investors about potential areas where the board may need reinforcing, but also aligns with proposed mandatory director training disclosures. Furthermore, it offers valuable insights for board succession planning over the longer term.

What's next for HKEx-listed boards?

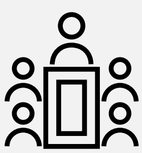
Before the updated governance requirements are finalized, HKEx-listed boards would do well to thoughtfully review the proposed corporate governance changes and evaluate the merits of implementing the recommended practices. Beyond optics and market-signaling, these changes present a substantial opportunity for boards to proactively anticipate upcoming changes.

To that end, HKEx-listed boards should consider the following:



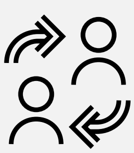
Embark on a comprehensive board effectiveness exercise

- Tackling these new requirements hinges on the board's ability and willingness to embark on a **comprehensive board effectiveness exercise**, using the results to drive the response to the new proposed corporate governance requirements.
- Key to this exercise is a **board composition analysis**, through which the board articulates what skillsets and experiences are required for it to help the company navigate the business landscape over the medium to long-term based on its chosen strategies.
- The analysis will result in a fleshed-out **board skills matrix**. This provides the board with both a measure for its current team and structure, as well as a roadmap of key attributes for its future slate of directors.



Re-examine the succession plan

- Taking the tenure of current independent directors in account adds further color to the director succession plan, as the board now knows when each director—and their associated skillset—will have to exit.
- With that insight, the nominating committee can then deliberate over what future succession profiles should look like, including considerations around the diversity requirements. This will allow for future board appointments to be more robust and better able to withstand scrutiny.



Keep an eye on the transition

- The three-year transition allowance should not be taken lightly, especially if the current board comprises exactly a third of long-tenured INEDs. Nominating committees will need to make use of this to avoid a "cliff" situation, in which the board suddenly has to swap out all the long-tenured INEDs at once.
- Where relevant, the appointment of lead independent directors (LIDs) also needs to be managed well, given the role expectations. Generally, a more seasoned and experienced director would be desirable—this is a factor the nominating committee needs to consider when succession-planning for this position. For example, should a sitting INED be appointed as LID or should the board embark on a search for one?

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About Russell Reynolds Associates

Russell Reynolds Associates is a global leadership advisory firm. Our 500+ consultants in 47 offices work with public, private, and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic, sustainability, and political trends that are reshaping the global business environment. From helping boards with their structure, culture, and effectiveness to identifying, assessing and defining the best leadership for organizations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led

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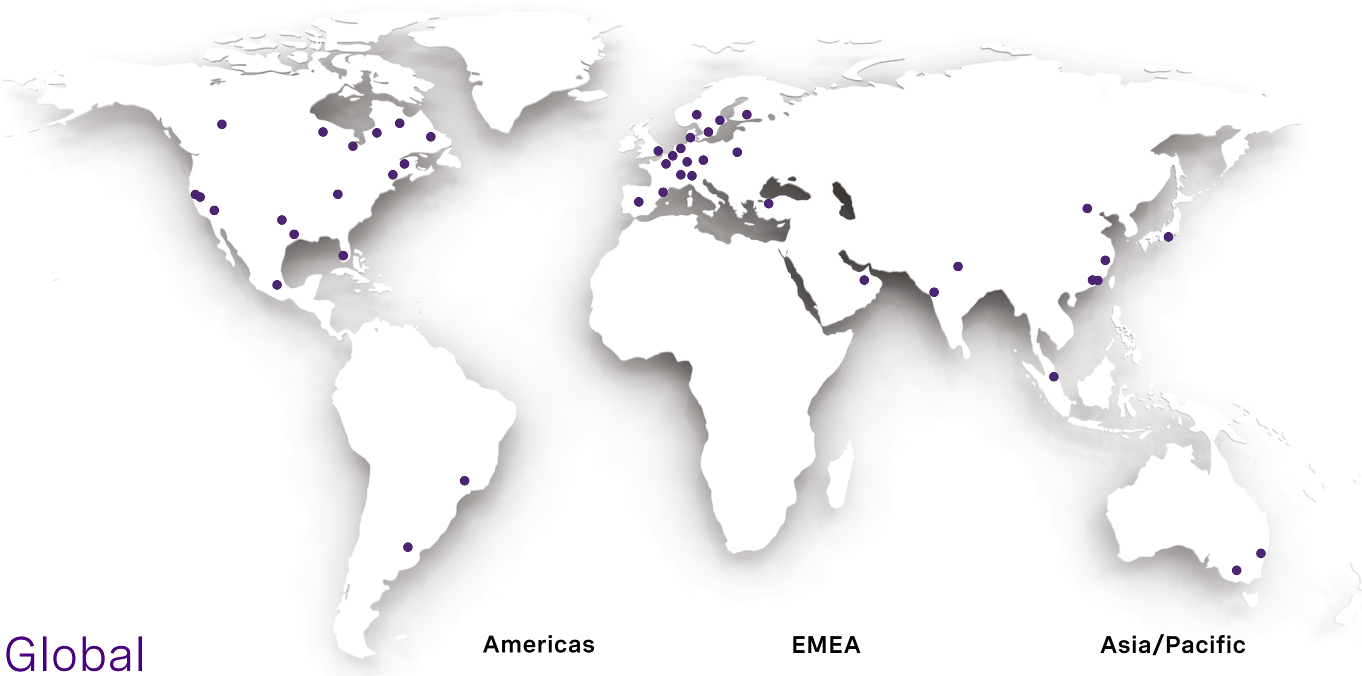

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