

# **The Hong Kong Mortgage Corporation Limited**

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## **Corporate Governance Code**

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## MESSAGE FROM THE CHAIRMAN

The core principles of good corporate governance: fairness, transparency, accountability and responsibility are especially relevant today and are fundamentally important in ensuring the integrity of companies and financial markets. As recognised by the HKSAR Government, good corporate governance standards are crucial to enhancing Hong Kong's status as an international financial centre.

In order to remain successful in an increasingly competitive market, the HKMC and its Directors have undertaken to adopt best practices and achieve high standards in its corporate governance regime. Good corporate governance assists the Board and Management to pursue objectives that are in the interest of the Corporation and its stakeholders, facilitates effective monitoring and encourages better and more efficient use of its resources.

The adoption of this Corporate Governance Code demonstrates the commitment of the Board and Management to achieve good corporate governance and to institutionalise those practices as part of the framework for the effective and prudent control and management of the Corporation. The Board and Management will aim to comply with the principles and provisions of the Code, and will carry out reviews of the Corporation's corporate governance practices periodically to ensure that these remain consistent with Hong Kong and international best practices.

A handwritten signature in black ink, appearing to be 'Henry Tang', written in a cursive style.

Henry Tang  
Chairman  
14 December 2004

## INTRODUCTION

Broadly speaking, the term "corporate governance" refers to the processes, and the related organisational structures, by which organisations are directed, controlled and held to account. It *"involves a set of relationships between an organisation's management, its Board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the organisation are set, and the means of attaining those objectives and monitoring performance are determined."*<sup>1</sup>

### **Development and Application of the HKMC's Corporate Governance Code**

The Insurance Authority ("IA") has published guidelines<sup>2</sup> on the corporate governance of authorized insurers which aim to enhance the integrity and well-being of the insurance industry of Hong Kong by providing assistance to authorized insurers for the evaluation and formulation of their internal practices and procedures. As an authorized insurer, the HKMC is under an obligation to ensure that its Code is consistent with the principles contained in the IA's guidelines.

In addition to complying with the IA's guidelines, the HKMC has, in preparing this Code, also drawn on relevant provisions in the corporate governance papers and reports issued by (i) the Standing Committee on Company Law Reform<sup>3</sup>, (ii) Hong Kong Exchanges and Clearing Limited<sup>4</sup>, (iii) the Hong Kong Institute of Certified Public Accountants (formerly the Hong Kong Society of Accountants)<sup>5</sup> and also other relevant international codes of corporate governance.

### **Self-Assessment Form**

This Code sets out the principles of good governance and the Code provisions which are concerned with the general management and responsibilities of the Board of Directors. Compliance with the Code provisions is monitored by way of a self-assessment form for completion by departments. An annual compliance report will be submitted for review by the Board. The Board is empowered to seek an explanation for non-compliance and to require that appropriate action be taken to remedy the non-compliance.

This Code and the self-assessment form provide the platform for the continuous monitoring and sustaining of good corporate governance practices in terms of fairness, transparency, accountability and responsibility in the course of the Corporation's pursuit of its business objectives.

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<sup>1</sup> Extracted from the preamble to the Principles of Corporate Governance of the OECD

<sup>2</sup> Guidance Note on the Corporate Governance of Authorized Insurers – July 2002

<sup>3</sup> A Consultation Paper on Proposals made in Phase II of the Corporate Governance Review – June 2003

<sup>4</sup> Draft Code on Corporate Governance Practices and Corporate Governance Report – January 2004

<sup>5</sup> Corporate Governance for Public Bodies – A Basic Framework – May 2004

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# THE HONG KONG MORTGAGE CORPORATION LIMITED

## CORPORATE GOVERNANCE CODE

### Part A - Board Structure and Processes

#### A.1 The Board

##### Principle

The Board is ultimately accountable and responsible for the performance and affairs of the Corporation. The Board is responsible for effective leadership and control of the Corporation and is collectively responsible for promoting the success of the Corporation by directing and supervising the Corporation's affairs. Directors should act in good faith and take decisions objectively in the best interests of the Corporation.

##### Code

A.1.1 The Board should meet regularly and Board meetings should be held at least four times a year at approximately quarterly intervals.

It is expected that Board meetings will involve active participation by Directors, either in person or through other electronic means of communication. For urgent matters requiring the attention of the Board before the next scheduled Board meeting, Board approval may be obtained through circulation of written resolutions.

A.1.2 Arrangements should be in place to enable Directors to include matters in the agenda for a Board meeting.

A.1.3 Prior notice of Board meetings should be given to all Directors well in advance (generally at least 14 days' prior notice) in order to give an opportunity for all Directors to attend.

A.1.4 If a Director has a conflict of interest in a matter to be considered by the Board, that Director shall declare his interest in such matter and abstain from voting on any Board resolution in which he or any of his associates has a material interest and he shall not be counted in the quorum present at the Board meeting at the relevant time when the matter is put to vote.

A.1.5 All Directors should have access to the advice and services of the Company Secretary with a view to ensuring that Board procedures and all applicable rules and regulations are followed.

A.1.6 Minutes of meetings of the Board and Board committees should be kept by the Company Secretary and available for inspection on reasonable notice by any Director except as regards any meeting papers and related materials in respect of which such Director has a conflict of interest.

Minutes of meetings of the Board and Board committees should record in sufficient detail the matters considered and decisions reached, including any concerns raised by Directors and dissenting views expressed.

Minutes of meetings of the Board and Board committee should be sent to all Directors as soon as practicable (and generally within 14 days after the meeting is held).

A.1.7 Appropriate directors' and officers' liability insurance cover should be maintained at all times in respect of legal actions against Directors and officers.

## **A.2 Chairman and Chief Executive Officer**

### **Principle**

There are two key aspects to the management of the Corporation – the running of the Board and the day-to-day management of the Corporation's business. There should be a clear division of responsibilities between the Chairman of the Board and the Chief Executive Officer (CEO) in order to ensure a balance of power and authority to avoid too much power being concentrated in any one individual.

### **Code**

A.2.1 The roles of the Chairman and CEO should not be performed by the same individual.

A.2.2 The Chairman should be responsible for the leadership of the Board and ensuring its effectiveness in all aspects of its role.

A.2.3 The Chairman should ensure that all key issues affecting the Corporation are discussed by the Board, and all Directors are properly briefed and provided with adequate and appropriate information in a timely manner on matters to be discussed at Board meetings.

A.2.4 The Chairman should ensure that good corporate governance practices and procedures are established and implemented.

- A.2.5 The executive responsibility for the running of the Corporation's business vests with the CEO.

### **A.3 Board composition**

#### **Principle**

The Board should have a balance of skills and experience appropriate for the business requirements of the Corporation. The Board should include a sufficient number of non-Executive Directors to ensure the objective and critical review and control of the management process, and the presence of a wider range of expertise on the Board for the effective leadership of the Corporation. The Board should also ensure that changes to its composition can be managed without undue disruption.

#### **Code**

- A.3.1 The Board should be of sufficient size so that the balance of skills and experience is appropriate for the requirements of the Corporation's business.
- A.3.2 The Corporation should maintain on its website an updated list of its Directors, identifying whether they are Executive Directors or non-Executive Directors.

### **A.4 Appointment, re-election and removal of Directors**

#### **Principle**

There should be a formal and transparent procedure for the appointment of new Directors to the Board.

#### **Code**

- A.4.1 All Directors shall be appointed by the shareholders of the Corporation who may designate one or more of them to be Executive Directors.
- A.4.2 All Directors, other than Executive Directors, shall be appointed for a specific term. All non-Executive Directors shall retire at the next annual general meeting of the Corporation following their appointment but shall be eligible for re-election.

- A.4.3 Executive Directors need not be subject to re-election whilst holding office.

## **A.5 Responsibilities of Directors**

### **Principle**

Every Director is required to keep abreast of his responsibilities as a director of the Corporation and of the conduct, business activities and development of the Corporation. Non-Executive Directors have the same duties of care and skill and fiduciary duties as Executive Directors.

### **Code**

- A.5.1 Every Director should ensure that he can give sufficient time and attention to the affairs of the Corporation and should not accept the appointment if he cannot do so.
- A.5.2 Every newly-appointed Director should receive a comprehensive induction on joining the Board and subsequent briefings, as appropriate, to ensure that he has a proper understanding of the operations and business of the Corporation, and his responsibilities and liabilities as a director under applicable laws and regulations.
- A.5.3 If any Director is at all in doubt about the nature of his responsibilities and liabilities, he should have ready access to the Company Secretary of the Corporation for advice and guidance.
- A.5.4 There should be a procedure agreed by the Board to enable Directors, on reasonable request, to seek independent professional advice which will be at the Corporation's expense, if considered appropriate.

## **A.6 Supply of and access to information**

### **Principle**

Directors should be provided in a timely manner with appropriate information in such form and of such quality as will enable them to make an informed decision and to discharge their duties and responsibilities as Directors of the Corporation.

### **Code**

- A.6.1 Except under exceptional circumstances, an agenda and accompanying Board papers should be sent in full to all Directors in a timely manner (and generally at least seven days before the intended

date of a Board meeting), except that where a Director has a conflict of interest with respect to a particular agenda item, the relevant Board paper should not be distributed to that Director.

- A.6.2 All Directors are entitled to have access to Board papers and related materials (except where a Director may have a conflict of interest). Where queries are raised by Directors, steps must be taken to respond as promptly and fully as possible.

## **A.7 Remuneration of Directors**

### **Principle**

To the extent applicable, the Corporation should disclose information relating to its Directors' remuneration policy and other remuneration related matters. There should be a formal and transparent procedure for setting policy on Directors' remuneration.

## **A.8 Delegation by the Board**

### **Principle**

The Board should have consistent policies governing delegation by the Board to Executive Directors of such powers and responsibilities on the day-to-day operations of the Corporation.

### **Code**

- A.8.1 When the Board delegates aspects of its management and administration functions to Executive Directors, it must at the same time give clear directions as to the scope of power so delegated, in particular, with respect to the circumstances where Executive Directors should report back and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Corporation.

## **A.9 Board committees**

### **Principle**

Board committees should be formed with specific written terms of reference which set out clearly the committees' authority and duties. Board committee is an aid to assist the Board in discharging its duties. However, the Board still bears the ultimate responsibility for the conduct and affairs of the Corporation.

**Code**

- A.9.1 The Board should establish an Audit Committee and other Board committee(s), as appropriate, as and when the business and structure of the Corporation develop to a stage that requires the establishment of such Board committee(s) for more efficient decision-making.
- A.9.2 The terms of reference of each Board committee should clearly set out how it is to be formed and its scope of authority, and require regular reporting back to the Board on its decisions or recommendations.
- A.9.3 All Board committees should preferably be chaired by a non-Executive Director.
- A.9.4 The composition of each Board committee, a brief description of its remit, the number of meetings held and other relevant information should be disclosed in the Annual Report.

## **Part B – Corporate Reporting and Disclosure**

### **B.1 Financial reporting**

#### **Principle**

The Board should present a balanced, clear and comprehensible assessment of the Corporation's performance, position and prospects.

To maintain transparency and enhance financial accountability, it is important that accounting policies and standards adopted by the Corporation are clear and consistent and, as far as possible, follow generally accepted accounting practice.

#### **Code**

- B.1.1 Directors should acknowledge their responsibility for preparing accounts which give a true and fair view of the financial status of the Corporation. There should be a statement by the auditors about their responsibility to form an independent opinion, based on their audit, on the accounts and to report their opinion. Directors should prepare the accounts on a going-concern basis, with such supporting assumptions or qualifications as necessary. When Directors are aware of material uncertainties relating to events or conditions that may cast significant doubt upon the Corporation's ability to continue as a going concern, such uncertainties should be clearly disclosed.
- B.1.2 The Board's responsibility to present a balanced, clear and understandable assessment extends to annual and half-yearly reports, reports to regulators and to information required to be disclosed pursuant to statutory requirements.
- B.1.3 Management should provide all necessary explanation and material to the Board for it to make an informed assessment of the financial and other information put before the Board consideration.

### **B.2 Internal reporting**

#### **Principle**

**Reporting by Board committees:** Regular and informative reporting to the Board is a prerequisite for the effectiveness of Board committees. Lines of reporting between the Board and Board committees should be formalised and set out in the terms of reference of the relevant Board committees. Reports to the Board and minutes of Board committee meetings should be formally approved by the relevant Board committee before submission to the Board.

**Reporting by management: Management** has the responsibility to support the Board by, amongst other things, ensuring that major issues are brought to the attention of the Board in a timely manner and that all relevant information is presented in a clear and concise way. Financial and non-financial performance and other accountability information should also be reported to the Board on a regular basis.

### **B.3 External reporting**

#### **Principle**

The Board should present a balanced and understandable assessment of the Corporation's position in reporting to shareholders and stakeholders (e.g. creditors and debenture-holders). The quality of the information should be based on the principles of openness and substance over form. Reporting should address material matters of significant interest and concern to shareholders and stakeholders.

#### **Code**

- B.3.1 External reporting should not be restricted to financial matters but should also include significant non-financial matters with a view to enhancing the transparency and accountability required for good corporate governance.
- B.3.2 The Annual Report should provide a clear and objective account and assessment of the Corporation's structure, activities, achievements, financial position and performance prospects.
- B.3.3 It is a good practice for the Annual Report to be made publicly available as part of the process of transparency and accountability.

### **B.4 Corporate governance disclosure**

#### **Principle**

The Board is responsible for corporate governance disclosure which should be by way of including a corporate governance section in the Annual Report containing the following information:

- corporate governance practice: a narrative statement of how the principles in this Code have been applied and a statement as to whether the Corporation has complied with the Code provisions;

- the Board of Directors: the composition of the Board, by category of Directors, including the names of the Chairman, the Executive Directors and the non-Executive Directors; number of Board meetings held during the year, a statement of how the Board operates and any delegation of responsibilities to Board committee(s); and any relationships, financial, business, or other material/relevant relationships, if any, among members of the Board;
- Chairman and CEO: the identity of the Chairman and Chief Executive Officer and whether the roles are segregated;
- auditors' remuneration: an analysis of remuneration in respect of the audit, audit-related and non-audit services provided by the auditors to the Corporation;
- internal control practice and procedure: an explanation of how the system of internal control has been defined; whether there is an internal audit department; how often internal controls are reviewed; and a narrative statement of how the Corporation has complied with the Code provisions on internal control;
- Audit Committee: the role, function and composition of the Audit Committee members (including their names and identifying the Chairman); the number of committee meetings held during the year; a report on the work performed by Audit Committee during the year, including its findings on review of the financial results and its other duties as set out in its terms of reference; and
- a statement of compliance with applicable legislation and regulations.

## Part C - Internal Control and Risk Management

### C.1 Internal control and risk management process

#### Principle

The system of internal control has a key role in the management of risks and fulfillment of the Corporation's business objectives. A sound system of internal control contributes to safeguarding the shareholders' investment and the Corporation's assets.

"**Internal control**" refers broadly to a process effected by the Board, management and other relevant personnel and designed to provide a reasonable assurance regarding the achievement of the following:

- safeguarding shareholders' investment and the Corporation's assets;
- effectiveness and efficiency of operations;
- reliability of internal and external reporting;
- compliance with the applicable laws, regulations and internal policies, including corporate governance policies; and
- proper utilisation of the Corporation's resources.

The **system of internal control** should:

- be embedded in the operations of the Corporation and form part of its culture;
- be capable of responding quickly to evolving risks to the business, whether arising from factors within the Corporation or from changes in the business environment; and
- include procedures for immediate reporting to the appropriate level of management any significant control failings or weaknesses together with details of corrective action being undertaken.

The Board is responsible for the total process of risk management, as well as for forming its own opinion on the Corporation's appetite or tolerance for risk and the effectiveness of the risk management process. Management is accountable to the Board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the Corporation.

The Board has the responsibility to ensure that the Corporation has implemented an effective ongoing process to identify risks, to measure their potential impact

against a broad set of assumptions, and then to activate what is necessary to manage those risks proactively.

## **Code**

C.1.1 The Board should undertake a systematic, documented assessment of the processes and outcomes surrounding key risks, at least annually. It should, at appropriate intervals, receive and review reports from the Audit Committee or management on the risk management processes of the Corporation. Management should conduct regular risk assessment reviews and address the Corporation's exposure to the following in its review reports:

- physical and operational risks
- credit and market risks
- technology risks
- compliance risks
- human resource risks
- business continuity and disaster recovery.

C.1.2 In addition to the Corporation's other compliance and enforcement activities, the Board should consider the need for a confidential reporting process covering fraud and other risks.

C.1.3 Reports from management on its regular risk assessment review should provide a balanced assessment of significant risks and the effectiveness of the system of internal control and risk management. Such reports should be reviewed by the Chief Internal Auditor who will then submit a report to the Audit Committee for review and comment and then to the Board for consideration.

C.1.4 When reviewing management's reports on internal control, the Audit Committee should:

- consider what the significant risks are and assess how they have been identified, evaluated and managed;
- assess the effectiveness of the related system of internal control in managing the significant risks, having regard, in particular, to any significant failings or weaknesses in internal control that have been reported;

- consider whether necessary actions are or have been taken promptly to remedy any significant failings or weaknesses; and
- consider whether the findings indicate a need for more extensive monitoring of the internal control system.

C.1.5 The Board is responsible for disclosures on risk management and should disclose:

- that it is accountable for the process of risk management and the system of internal control, which is regularly reviewed for effectiveness and for establishing appropriate risk and control policies and communicating these throughout the Corporation;
- that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Corporation, that has been in place for the year under review and up to the date of approval of the annual report and financial statements;
- that there is an adequate system of internal control in place to mitigate the significant risks faced by the Corporation to an acceptable level. Although such a system can only provide reasonable assurance but not absolute guarantee that all risks are fully eliminated, the system should be designed to manage the risk of failure and maximize opportunities to achieve business objectives as far as possible; and
- that there is a documented and tested process in place that will allow the Corporation to continue its critical business processes in the event of a disastrous incident impacting on its activities.

Disclosure shall take the form of publication in the Annual Report of the Corporation a statement on the operation of its risk management system for the past year.

## **C.2 Internal audit**

### **Principle**

Internal audit should be an independent and objective assurance and consulting activity to add value to and improve the Corporation's operations. It helps the Corporation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

An effective internal audit function should provide:

- assurance that the management processes are adequate to identify and monitor significant risks;
- confirmation of the effective operation of the established internal control systems;
- credible processes for feedback on risk management and assurance; and
- objective confirmation that the Board receives the right quality of assurance and information from management and that such information is reliable.

## **Code**

C.2.1 The annual internal audit plan should be based on risk assessment as well as on issues highlighted by the Audit Committee and management. The risk assessment process should be of a continuous nature as to identify not only residual or existing but also emerging risks and should be conducted formally at least annually, and more often as the organisation and business of the Corporation become more complex. This risk assessment should be coordinated with the Board's own assessment of risks.

C.2.2 The Audit Committee should approve the annual internal audit work plan.

C.2.3 The internal audit function should coordinate with other internal and external providers of assurance to ensure proper coverage of financial, operational and compliance controls and to minimise duplication of effort.

C.2.4 In order to be effective, internal audit should be, as far as possible, operationally independent of the management. Its work should also be given sufficient weight within the Corporation so that any significant matters of concern discovered by internal audit are quickly brought to the attention of CEO and the Audit Committee.

Accordingly, the Chief Internal Auditor should have the right of direct access to the Board or to the Audit Committee through the Chairman of the Board or the Audit Committee Chairman, as appropriate, on relevant matters of concern.

## **C.3 Audit Committee**

### **Principle**

The Board should establish formal and transparent arrangements for considering

how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the Corporation's external auditors. The Audit Committee plays an important role in the control and risk management framework of the Corporation.

### **Code**

- C.3.1 The Audit Committee should make available its terms of reference setting out its role and the authority delegated to it by the Board. The terms of reference of the Audit Committee are set out in the **Annex**.
- C.3.2 Where the Board disagrees with the Audit Committee's view on the selection, appointment, resignation or dismissal of the external auditors, the Board should include in the corporate governance section of the Annual Report a detailed explanation of the Audit Committee's view and also the reason(s) why the Board has taken a different view.

## **C.4 Compliance with statutory, regulatory and contractual requirements**

### **Principle**

The Corporation should establish effective mechanisms to ensure that it complies with all applicable laws and regulations, and any non-statutory guidelines and codes. Individual departments are responsible for ensuring compliance with the statutory, regulatory and contractual requirements applicable to their daily business.

### **Code**

- C.4.1 The Board should ensure that the Corporation observes and performs its contractual obligations and complies with all applicable laws, regulations, guidelines, industry standards and codes of practice and procedures. Accordingly, all departments should identify and familiarise themselves with all applicable laws, regulations, guidelines, industry standards and codes of practice and procedure, and contractual obligations relevant to their respective businesses and keep abreast of any amendment and updates to them.

## **Terms of reference of the Corporation's Audit Committee**

### **1. Membership**

The Audit Committee shall comprise not less than four Directors appointed by the Board, one of whom must be an Executive Director.

Two members shall form a quorum for a meeting of the Audit Committee.

### **2. Terms of reference**

The terms of reference of the Audit Committee are as follows:

- (a) to review the Corporation's financial statements, the composition and accounting principles adopted in such statements, whether these are intended to be audited or not;
- (b) to advise on the form and content of the financial statements of the Corporation;
- (c) to examine and review with both the external and internal auditors the scope and results of their audits;
- (d) to review the findings, recommendations or criticisms of the auditors, including their annual management letter and management's response;
- (e) to review the Corporation's management procedures to ensure the effectiveness of internal systems of accounting and control, and management's efforts to correct deficiencies discovered in audits;
- (f) to initiate investigations or audit reviews into any activities of the Corporation which may be of concern or interest to the Audit Committee; and
- (g) to consider any other matters referred to it by the Board, and to report on such matters to the Board.

### **3. Authority**

The Audit Committee is authorized by the Board to investigate any activity within its terms of reference. It is authorised to seek any information it requires from any employee of the Corporation and all employees are directed to cooperate with any request made by the Audit Committee.

The Audit Committee is authorised by the Board to obtain outside legal or other independent professional advice and to secure the attendance of outsiders with relevant experience and expertise if it considers this necessary.

The Audit Committee shall have no executive powers as regards its findings and recommendations.

#### **4. Meetings**

Meetings shall be held not less than twice a year. The external auditors may request a meeting if they consider that one is necessary.

The Company Secretary shall attend its meeting and take minutes, copies of which shall be circulated to the Board. The CEO shall be entitled to attend the Audit Committee's meetings. In all other respects, the Audit Committee shall decide its own procedures.