

China/Hong Kong Policies – Proposals regarding Chinese Communist Party Committees

Background and Overview

The Chinese Communist Party (CCP or Party) and Chinese Company Law have long imposed a requirement for state-owned enterprises (SOEs) to establish a Party Committee to facilitate Party activities and the implementation of government policies. By law, all Chinese SOEs shall have a Party secretary as the chairman of the board. A 2015 Party Directive added the requirement that SOEs include language relating to the Party Committee in their Articles of Incorporation (Articles).

Nonetheless, no law or regulation explicitly grants the Party Committee the authority to override a corporate board that is legitimately set up by shareholders, and the board has full discretion over how the Articles are amended to reflect the requirements stipulated by the Party Directive.

The 2015 Party Directive neither stipulates a timeframe by which SOEs must amend their Articles, nor does it specify any penalties for failure to do so. If the resolution fails to receive shareholder approval, the company may revise the proposal and resubmit it for shareholder vote.

Governance issues and concerns about potential conflicts of interest may be raised by the following factors. Most companies neither delineate the responsibilities of the Party Committee from those of the corporate board of directors or its key committees, nor specify clearly the actual interaction between the two entities when making material decisions. Party Committees' members are not necessarily directors elected by shareholders and, as such, they are generally not accountable to shareholders. Disclosures about the actions of these committees and their members are not transparent.

Key Changes Under Consideration

ISS proposes a new policy to generally recommend a vote against article and/or bylaw amendments regarding Party Committees where the proposed amendments lack transparency or are not considered to adequately provide for accountability and transparency to shareholders.

Intent and Impact

A specific policy regarding article and bylaw amendments to establish, or formalize the existence of, a Chinese Communist Party Committee (Party Committee) in listed companies is needed due to the increasing number of such proposals.

Given that most companies neither delineate the responsibilities of the Party Committee from those of the board of directors or its key committees, nor specify clearly the actual interaction between the two when making material decisions, many institutional investors and other market participants, favor a more exacting approach to these proposals.

To assess the potential impact of the new policy, ISS examined 156 proposals or roughly 75 percent of the total number of amendments to Articles of Association to establish, or formalize the existence of, a Party Organization/Party Committee of the proposals covered by ISS from August 2015 through July 2017. One-hundred and twenty-three proposals, about 79 percent of the sample, received a negative vote recommendation from ISS due to concerns or lack of transparency about the influence of the Party Committee on the board's decision-making process. Under the proposed new policy, all such proposals would have warranted an against recommendation given the general lack of transparency, an increase of 33 proposals.

Request for Comment

While we appreciate any comments on this topic, ISS is specifically seeking feedback on the following:

- Under what conditions or limitations to the power of the Party Committee should ISS make an exception to the proposed policy, and recommend for the establishment of a Party Committee?
- Are there other exceptions to the proposed policy (e.g., any potential risks or concerns) that should be considered? If yes, please specify.