

ANALYSIS ON NEW REGULATIONS AND FUTURE ROAD OF INDEPENDENT DIRECTORS IN CHINA

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Abstract

Based on the history of the independent directors system in China, this article mainly reviews the significant changes made by the China Securities Regulatory Commission (CSRC) in Measures for the Administration of Independent Directors of Listed Companies issued on August 1, 2023, compared with the previously issued Rules for Independent Directors of Listed Companies and analyzes the progress and shortcomings of this revision from the perspective of comparative law compared with the UK. Furthermore, drawing on the historical experience of the UK, this article raises the suggestion on clarifying the role of independent directors and focusing more on capacity as well as management function rather than the independent character and supervisory duty.

Keyword: Independent Directors, Company Law, Supervisory Duty

I. INTRODUCTION TO INDEPENDENT DIRECTORS IN CHINA

Compared with developed countries such as the United Kingdom and the United States, the capital market in China is comparatively undeveloped, and the history of the independent director system of listed companies is also shorter. Driven by practice in recent years, China has accelerated the regulation of independent directors. In particular, the latest *Measures for the Administration of Independent Directors of Listed Companies* issued by the China Securities Regulatory Commission (CSRC) in August 2023 have made significant modifications in the appointment and removal procedures, the requirement of performing duties and legal liabilities of independent directors, which marks a significant improvement of the independent director system in China. Although the practical effect of the new regulation remains to see, this amendment undoubtedly lays the foundation for further institutional construction. It is conducive to promoting independent directors to become a real supervisory force.

A. *Brief history of legislation*

The Opinions on Further Promoting the Standardized Operation and Deepening Reform of Overseas Listed Companies was promulgated in March 1999, which, for the first time, required that there should be at least two or more independent directors in listed companies.¹ Then, *The Guiding Opinions on the Establishment of an Independent Director System*

¹ Guanyu Jinyibu Cujin Jingwai Shangshi Gongsì Guifan Yunzuo he Shenhua Gaige de Yijian (关于进一步促进境外上市公司规范运作和深化改革的意见) [The Opinions on Further Promoting the Standardized Operation and Deepening Reform of Overseas Listed Companies] (promulgated by the CSRC & State Economic and Trade Commission, Mar. 29, 1999, effective Mar. 29, 1999) art. 6 (Chinalawinfo).

in *Listed Companies* was published in 2001. The primary purpose of this rule was to solve the problem of ‘one share dominance’² insider control and the absence of supervisors for the board of directors, which were prevalent in listed companies in China.³ It detailed the relevant requirements for independent directors in listed companies. The system of independent directors of listed companies in China has begun to take shape since then, including the requirements for qualification, election procedures, duties, independence and performance. After that, the China Association of Listed Companies published the *Guidelines for the Performance of Duties by Independent Directors of Listed Companies* as an industry regulation in 2014 and revised it in 2020, adding independent opinions on ‘over-raised funds used to permanently supplement working capital and return bank loans’ and ‘listed companies voluntarily delisting,’⁴ and simultaneously compiled the *Independent Directors to promote the Internal Control of Listed Companies work Guidelines*. Although these two provisions detailed the rules of independent directors, they did not impose compulsory effect and only serve as industry regulations for reference.

It was not until January 2022 that a systematic and independent rule, *the Rules for the Independent Directors of Listed Companies*, was formed, integrating the provisions on independent directors scattered in different department laws, which mainly include Article 90 of the Securities Law,⁵ Article 122 of the Company Law,⁶ etc. In August 2023, the CSRC made a comprehensive amendment to the law, refining the norms according to the actual development and policy and forming the latest *Measures for the Administration of Independent Directors of Listed Companies* containing 48 articles. Correspondingly, the self-regulatory guidelines and stock listing rules of the Shenzhen Stock Exchange, Shanghai Stock Exchange, and Beijing Stock Exchange were revised.⁷

² ‘One share dominance’ is also called as ‘Yigu Duda’ in China, which means that in the share capital structure of a listed company, a certain shareholder, usually owning over 50% equity, can absolutely control the operation of the company.

³ Wang Yong (王涌), *Duli Dongshi de Dangze yu Keze* (独立董事的当责与苛责) [*The Accountability and Liability of Independent Directors*], ZHONGGUO FALÜ PINGLUN (中国法律评论) [CHINA LAW REVIEW] 64, 68 (2022).

⁴ Fu Qiong (傅穹), *Sifa Shiye xia Duli Dongshi de Zeren Fansi yu Chuangxin* (司法视野下独立董事的责任反思与制度创新) [*The Responsibility Reflection and System Innovation of Independent Directors Under the Judicial Perspective*], FALÜ SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION] 24, 28 (2022).

⁵ Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 28, 2019, effective Mar. 1, 2020), art. 90 (Chinalawinfo).

⁶ Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 26, 2018, effective Oct. 26, 2018), art. 122 (Chinalawinfo).

⁷ Mainly including the Stock Listing Rules of the Shenzhen Stock Exchange (August 2023 Revision) (深圳证券交易所股票上市规则 (2023年8月修订)), the Rules of the Shenzhen Stock Exchange for Stock Listing on ChiNext (August 2023 Revision) (深圳证券交易所创业板股票上市规则 (2023年8月修订)), Self-regulatory Guidelines for Companies Listed on the Shenzhen Stock Exchange No. 2 - Standardized Operation of ChiNext Listed Companies (2023 Revision) (深圳证券交易所上市公司自律监管指引第2号——创业板上市公司规范运作 (2023年修订)), the Rules Governing the Listing of Stocks on Shanghai Stock Exchange (August 2023 Revision) (上海证券交易所股票上市规则 (2023年8月修订)), the Rules Governing the Listing of Stocks on the STAR Market of the Shanghai Stock Exchange (Revised in August 2023) (上海证券交易所科创板股票上市规则 (2023年8月修订)), Shanghai Stock Exchange Listed Companies Self-Regulatory Guidelines No. 1 - Standardized operation (August 2023 Revision) (上海证券交易所上市公司自律监管指引第1号——规范运作 (2023年8月修订)), Self-regulatory Guidelines for Listed Companies on the Science and

B. Issues Encountered Previously

Despite the legislative supervision, the independent director system is far from perfect in China. The ‘independence’ of independent directors is insufficient, and they tend to fail in executing external supervision. In practice, after the nomination, they are ultimately selected by the de facto controllers in the name of the resolution of the shareholders’ meeting. Due to centralized shareholder structure, this mechanism prompts their susceptibility to the control of dominant shareholders, so that they lack the initiative to safeguard the interests of public shareholders,⁸ which should remedy through additional restrict during nomination and selection.

Additionally, many independent directors lack the ability and motivation to perform due diligence. Most independent directors in China are university professors, accounting for nearly 40%, who are short of practical experience, and the reputation mechanism of the capital market has less restraint impact on them.⁹

What’s more, the actual influence of independent directors on the market is quite weak. Some scholars believe that independent directors in China are relatively to meet the regulatory requirements, and whether the independent directors are good or bad cannot reflect positive or negative signals to the market, and even the decorative function as ‘vase’ has not been reached.¹⁰ Namely, whether an independent director signs or not does not materially affect the judgment of investors.¹¹ Despite possibly being overstated, these arguments reveal that the futility of independent directors is a significant problem for the supervision of listed companies in China.

In the relevant cases, the boundary and liability of the due diligence for independent directors are in dispute.¹² In recent years, the responsibility of independent directors in false statements has become a focus in regulation

Technology Board of the Shanghai Stock Exchange No. 1 - Standardized Operation (August 2023 Revision) (上海证券交易所科创板上市公司自律监管指引第1号——规范运作(2023年8月修订)), Guidance on the Continuous Supervision of Companies Listed on the Beijing Stock Exchange No. 1 - Independent Directors (北京证券交易所上市公司持续监管指引第1号——独立董事), etc.

⁸ Liu Junhai (刘俊海), *Shangshi Gongsi Duli Dongshi Zhidu de Fansi he Chonggou - Kangmei Yaoye Anzhong Dudong Jue Liandai Peichang Zeren de Falv Sikao* (上市公司独立董事制度的反思和重构——康美药业案中独董巨额连带赔偿责任的法律思考) [*Reflection and Reconstruction of the Independent Director System of Listed Companies: Legal Consideration on the Huge Joint and Several Liability of the Independent Directors in Kangmei Pharmaceutical Case*], FAXUE ZAZHI (法学杂志) [LAW SCIENCE MAGAZINE] 1, 10 (2022).

⁹ Huang Hui (黄辉), *Duli Dongshi de Falv Yiwu yu Zeren Zhuijiu: Guoji Jingyan yu Zhongguo Fangan* (独立董事的法律义务与责任追究：国际经验与中国方案) [*Legal obligations and accountability of independent directors: International experience and Chinese solutions*], ZHONGWAI FAXUE (中外法学) [PEKING UNIVERSITY LAW JOURNAL] 201, 210 (2023).

¹⁰ See Huang, *supra* note 9, at 213.

¹¹ Wu Yue (吴越), *Zhongmei Duli Dongshi Guize Yuanze yu Caipan Biaozhun Yanjiu* (中美独立董事归责原则与裁判标准研究) [*Study on the Imputation Principle and Adjudication Standard of Independent Directors in China and America*], JINGMAO FALV PINGLUN (经贸法律评论) [BUSINESS AND ECONOMIC LAW REVIEW] 87, 106 (2022).

¹² Zhang Tingting (张婷婷), *Duli Dongshi Qinmian Yiwu de Bianjie yu Zhuize Biaozhun - Jiyu 15 Jian Duli Dongshi Weijin Qinmian Yiwu Xingzheng Chufaan de Fenxi* (独立董事勤勉义务的边界与追责标准——基于 15 件独立董事未尽勤勉义务行政处罚案的分析) [*The Boundary of Independent Directors' Duty of Diligence and The Standard of Accountability: Based on the Analysis of 15 Cases of Administrative Punishment for Independent Directors' Failure to Perform Diligence Duty*], FALU SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION] 84, 84(2020).

after Kangmei Pharmaceutical case occurred in China in 2021.¹³ In this case, the independent directors of the company were judged to bear 5%-10% joint liability for signing the documents with false disclosure. Due to the vast amount of compensation, the independent directors personally bore the sky-high fine of 246 million yuan, which shocked both the academic and practical circles, triggering the resignation wave of independent directors of listed companies. Therefore, the discussion on performance obligations and punishment of independent directors once became a hot-spot issue. *The Supreme People's Court issued Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market* in 2022, specifying the exception of the responsibility of independent directors in the article,¹⁴ including having found no problem with resort to help from accountants or lawyers, raising objections or submitting reports in writing to Stock Exchange after realizing misrepresentation before the date of exposure or correction, voting for but keeping reserved or objective opinions, impediment from issuer and other demonstrate diligence. However, due to the rule's ambiguity, there is still a lot of controversy.

II. NEW RULE HIGHLIGHTS

Although the above problems have not completely solved in the latest rule, *Measures for the Administration of Independent Directors of Listed Companies* further clarifies the work content and requirements of independent directors institutionally, establishes a complete supporting mechanism for them to perform their duties, further displays the purpose and significance of the independent director system. There are many highlights deserving of praise.

A. Modifications

1. Election Regarding selection qualifications, the requirement of independence from the actual controller added.¹⁵ Members of the audit committee shall not concurrently serve as executives of listed companies.¹⁶ The moral character requirements also added.¹⁷

As for the election procedure, the right of the investor protection institutions to nominate independent directors through shareholder

¹³ Guhuajun, Huangmeixiang deng 55326 ming Touzi Zhedeng Zhengquan Xvjia Chenshu Zeren Jiufen Minshi Yishen Minshi Panjue Shu (顾华骏、黄梅香等55326名投资者等证券虚假陈述责任纠纷民事一审民事判决书) [Gu Huajun, Huang Meixiang, etc. 55,326 investors v. Kangmei Pharmaceutical Co., Ltd], (2020) 粤01民初2171号 (Guangzhou Intern. People's Ct. 2020).

¹⁴ Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang Xujia Chenshu Qinquan Minshi Peichang Anjian de Ruogan Guiding (最高人民法院关于审理证券市场虚假陈述侵权民事赔偿案件的若干规定) [Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market] (promulgated by Sup. People's Ct. Jan. 21, 2022, effective Jan. 22, 2022) art. 16 (Chinalawinfo).

¹⁵ Shangshi Gongsi Duli Dongshi Guanli Banfa (上市公司独立董事管理办法) [Measures for the Administration of Independent Directors of Listed Companies] (promulgated by the CSRC, Aug. 1, 2023, effective Sep.4, 2023) art. 2 (Chinalawinfo).

¹⁶ *Id.* art. 5.

¹⁷ *Id.* art. 7.

entrustment has enhanced.¹⁸ Within the company, the election of more than two independent directors should implement the cumulative voting system, and the voting situation of minority shareholders should counted separately and disclosed.¹⁹

2. Perform Duties With regard to execution, more detailed and higher standards are required for independent directors regarding their duties. For example, the upper limit of independent directors has been reduced from 5 to 3,²⁰ and independent directors must work on-site for at least 15 days and keep job logging.²¹ In addition, the retention period of information provided by listed companies to independent directors has been extended from 5 years to 10 years.²² They should also conduct an annual self-examination of independence and submit a report to the board.²³ They will dismissed if absent from two board meetings consecutively, while the minimum was three before.²⁴

In particular, the matters requiring the prior approval of independent directors have changed. The specific standards of related party transactions have deleted, ‘need to disclose’ has been taken as the new subjective standard. Two matters have added, ‘the plans of the listed company and the relevant parties for the modification or waiver of their undertakings’ and ‘the decisions made and measures are taken by the board of directors of the target listed company regarding the acquisition.’²⁵ The proposal to the board to hire or dismiss the accounting firm has deleted.²⁶

Also, more measures are provided to guarantee their execution. The right to be informed has been better protected, and the company must render necessary conditions and personnel support for their performance of duties.²⁷ And more emphasis has been placed on the disclosure of objections to independent directors.²⁸

3. Establish New System. The CSRC puts the suggestion of construction of an independent director system into practice, attempting to establish a standardized and unified system for election. Namely, China Association of Listed Companies is responsible for the construction and management of the information base of independent directors of listed

¹⁸ *Id.* art. 9.

¹⁹ *Id.* art. 12.

²⁰ *Id.* art. 8.

²¹ *Id.* art. 30 and 31.

²² *Id.* art. 31.

²³ *Id.* art. 6.

²⁴ *Id.* art. 20.

²⁵ *Id.* art. 23.

²⁶ Shangshi Gongsi Duli Dongshi Guize (上市公司独立董事规则) [the Rules for the Independent Directors of Listed Companies] (promulgated by the CSRC, Jan. 5, 2022, effective Jan. 5, 2022) art. 22 (Chinalawinfo).

²⁷ Shangshi Gongsi Duli Dongshi Guanli Banfa (上市公司独立董事管理办法) [Measures for the Administration of Independent Directors of Listed Companies] (promulgated by the CSRC, Aug. 1, 2023, effective Sep. 4, 2023) art. 36 (Chinalawinfo).

²⁸ *Id.* art. 21.

companies. The listed company may hire independent directors from the base.²⁹

Besides, the provisions on special meetings of independent directors added, requiring listed companies to regularly or irregularly hold meetings attended by all independent directors to review relevant matters. Particularly, such issues such as disclosure of related party transactions, alteration or exemption of commitments, and anti-takeover measures shall be approved in advance by the special meeting of the independent directors before being submitted to the board of directors for deliberation.³⁰

4. Accountability The amendment particularly sets a fifth chapter titled ‘Legal Management and Legal Liability,’ adding five provisions to regulate the accountability of independent directors. Generally, the stock exchanges and the China Association of Listed Companies have explicitly authorized the right to formulate relevant self-regulatory rules to promote more detailed supervision.³¹ If independent directors violate the regulation, except for formal administrative penalty, the CSRC can take measures involving ordering the violator to take corrective action, holding a regulatory interview, issuing a letter of caution, ordering a public explanation, and ordering the violator to submit periodical reports.³²

To determine independent directors’ due diligence, there are both positive criteria and exceptions for exemption. The active standard can be relatively general, referring to independent directors’ role in the information formation and related decision-making process, the source and content of information, the degree of knowing the information and attitude after knowing the information, the degree of attention to relevant abnormal circumstances and the measures taken to verify information, attendance at the relevant meetings of the board of directors and its special committees, and the special meetings of independent directors and professional background or industry background.³³ But admirably, it renders a more feasible and ascertainable reference in statutory form.

As for exemption, apart from that in judicial interpretation discussed above, the intentional concealment from issuers is added. The requirement to choose between raising objections or submitting reports is replaced with a mandatory simultaneous execution of both to remit penalty.³⁴ And the independent directors should not only raise objective opinions but also vote against the proposals.³⁵ Notably the exception in latest rule is, though mainly aiming at false statement, for all the essential duties, and the previous article has not been invalidated by the new rule.

²⁹ *Id.* art. 6.

³⁰ *Id.* art. 24.

³¹ *Id.* art 42.

³² *Id.* art 44.

³³ *Id.* art 45.

³⁴ *Id.* art 46.

³⁵ *Id.* art 46.

B. Vital Significance of Modifications

As discussed above, the overall statutes have amended in an extensive range, and there are many changes in regulations. The CSRC has made many new attempts to establish the independent director system and has made the response to previous problems raised above.

First of all, from the perspective of independence, the interests between actual controllers and independent directors are explicitly excluded. The possibility of public shareholders' participation is increased through the nomination of the investor protection institution and the cumulative voting mechanism in the process of election and appointment of the independent directors so that the independent directors are more inclined to the public shareholders from the source rather than entirely subject to the major shareholders and actual controllers of the company.

Secondly, mandatory requirements have been made in the maximum number of companies they hold office, the minimum number of days of on-site work, the submission of self-inspection reports, and the attendance of the board of directors in person so that independent directors can gradually perform their duties in a more standardized state. Although the proposed standards are not quite strict in substance and the urging role played in the implementation process may be quite limited, when we have the standard prototype, it will be easier to refine and adjust the standard according to the actual situation in the subsequent revision.

In addition, by changing the content that needs to be reviewed by independent directors, demanding cooperation from the company, and adding special meetings of independent directors, we can see the intention of lawmakers to enhance the impact of independent directors on the company and the capital market, from both management and supervision prospects. While the efficacy remains to see, we should confirm that it is a good start.

Finally, as analyzed above, it seems that the administrations have noticed the issue of responsibility and underline the disclosure of all the unusual situation concerning independent directors. Remarkably, for the responsibility, there are relatively concrete factors to consider when we discuss whether independent directors should undertake the consequence for the issuers' misconduct. The perpetual problem here is not whether independent directors bear duty of diligence, but rather the boundary between the duty of diligence and the exemption. Previously, the existing problems for administrative responsibility included that signature equaled responsibility, the role of independent director presumed to have the responsibility, the responsibility presumed from the result, and the burden of proof inverted.³⁶ Given the tendency of adding more exemptions recently, we can see the endeavor of the CSRC to balance the duties and remission of independent directors. Also, in the most recent cases, two independent directors of Ropt Technology Group Co., Ltd were separately fined 500,000 yuan for false disclosure by the CSRC, overruling their pleading with precise reference to the criteria and exemptions listed

³⁶ See Wu, *supra* note 11, at 91-92.

above,³⁷ and the amount of penalty was more reasonable compared to that in Kangmei Pharmaceutical case. To sum up, the new boundary has been set by the new rule, being a preliminary guidance to supervision, but it is undeniable that more details must be supplemented through judicial process or future judicial explanations.

C. *Issues Remain to Be Considered*

However, the role of independent directors needs further discussion regardless of significant improvements of the rule. In the regulations, the performance and appointment of independent directors are detailed, and it seems to expect that they can participate more in the company's management and play more substantive supervisory roles. But meanwhile, we should not expect too much from independent directors, since the inside information of independent directors is always limited,³⁸ which means that the information of aforementioned misconduct from the board or management is not possible to be known and discovered by them.

Under these circumstances, if we want the function of independent directors to realize on one side, we must make concessions on the other side. To be specific, if they are expected to fulfil their management responsibilities, they need to correspondingly abandon excessive demands on their general independence, since over-demanding independence will impair their passion and effort to safeguard the interest of companies. In this approach, the corporate performance is linked with their involvement through an appraisal mechanism by the CSRC or other administration, which distinguishes them from inner directors but promotes their enthusiasm for management. This may be achieved by expanding the system of independent director base mentioned in 'Establish New System' modified part. We will continue to discuss independence, management function, and other related concepts in part III (III) (b).

According to practice in China, the overall system of independent directors is still developing and it may not have reached the stage where one side has to make concessions. But in the future, it is necessary to adjust the regulation to focus more on one side.

III. COMPARATIVE VISION

A. *Independent director in China v. non-executive director in the UK*

In China, the concept 'outside director' and 'independent director' were used together in the early days.³⁹ Nowadays, the two concepts have been integrated as 'independent director' in most rules, except for 'outside

³⁷ Zhongguo Zhengquan Jiandu Guanli Weiyuanhui Xiamen Jianguanju Xingzheng Chufa Jueding Shu (中国证券监督管理委员会厦门监管局行政处罚决定书〔2023〕2号) [China Securities Regulatory Commission Xiamen Regulatory Bureau Administrative Penalty Decision (2023) No. 2].

³⁸ See Wu, *supra* note 11, at 93.

³⁹ Mainly in *The Opinions on Further Promoting the Standardized Operation and Deepening Reform of Overseas Listed Companies* in 1999 and *The Guiding Opinions on the Establishment of an Independent Director System in Listed Companies* in 2001, in which the 'outside director' and 'independent director' were recklessly mixed.

director' in some supervision documents of state-owned enterprises.⁴⁰ In the UK, there is a conceptual distinction between executive directors and non-executive directors, and also a distinction between 'independent' and 'non-independent' for non-executive directors. According to the interpretation of independence in the European Commission Recommendation,⁴¹ China's 'independent director' should correspond to the British independent non-executive director.

B. *History of the independent non-executive director in the UK*

The system of independent directors in the UK has a more extended development history than in China. The concept of monitoring by non-executive directors was first promoted by industry but not by the government in the early 1980s.⁴² Then the committee was set up by the financial sector in 1991, and Cadbury Report was published the following year, which laid the foundation of the 'comply-or-explain' principle and requirement of director independence. Accordingly, the Cadbury Code of Best Practices proposed a board staffed with at least three non-executive directors, the most of which should be independent.⁴³ In 2003, Higgs Report was put forward, comprehensively reviewing the non-executive director system in UK listed companies. Since then, the London Stock Exchange has revised the 1998 combined Code based on the recommendations of the Higgs Report, as well as the Turnbull Report in 2001 and the Smith Report in 2003. In the 2006 revision of the Combined Code, it was recommended that half of the board members of large companies should be independent non-executive directors.⁴⁴ The Combined Code was transformed into the UK Corporate Code in 2010, in which the emphasis was transformed into the appropriate balance of skills, experience, independence and knowledge of the company of independent non-executive director to discharge their duties.⁴⁵ The UK Corporate Governance Code authorizes the board to decide whether directors are qualified as independent.⁴⁶

⁴⁰The concept of 'outside director' is broader than that of 'independent director' in China, and the former is similar to the non-executive director. But at present, only in the case of state-owned enterprises will use the 'outside director' to refer to the role as non-executive director.

⁴¹Commission Recommendation (2005/162/EC) of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, OJ L 52/5, Section 13.1.

'[a] director should be considered to be independent only if he is free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgment.'

⁴²YUAN ZHAO, CORPORATE GOVERNANCE AND DIRECTORS' INDEPENDENCE 30.

⁴³Paul Davies, *Corporate Boards in the United Kingdom*, in P. L. Davies, K. J. Hopt, R. Nowak and G. van Solinge eds., *Boards in Law and Practice*, Oxford University Press, 2013, 738.

⁴⁴Harald Baum, *The Rise of the Independent Director: A Historical and Comparative Perspective*, in Dan W. Puchniak, Harald Baum, and Luke R. Nottage, eds., *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, Cambridge University Press, 2017, 21.

⁴⁵UK Corporate Governance Code, FRC, June 2010, at 12. 'The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.'

⁴⁶See Zhao, *supra* note 42, at 740.

C. Comparison and inspiration

1. Comparison The independent director system in the UK has its features and is quite distinct from China's due to the origin and development path. Nevertheless, we can still acquire a lot of inspiration from it, assisting Chinese future improvement.

To begin with, the shareholding in UK listed companies are 'semi-dispersed' with international investors and domestic institutional shareholders.⁴⁷ On the contrary, China's shareholding is mainly in the hands of major shareholders and is relatively concentrated. Based on these, the original purpose of independent directors in China is to alleviate the problems caused by shareholding concentration, safeguard the interests of minority shareholders,⁴⁸ and strengthen external supervision,⁴⁹ while that of the UK mainly aims to address the agency conflicts between managers and owners with dispersed ownership.⁵⁰

However, compared to the US, the structure of company governance in the UK is perceived more as 'shareholder-centric',⁵¹ which means that the shareholders bear more power in nomination, dismissal of directors and installation of a new board.⁵² To be specific, the trend of recentralization of shareholders in the UK benefits from both pro-shareholder governance rules and the rise of institutional shareholders, leading to increasing impacts on management.⁵³ Analogously, the ownership of Chinese listed companies is highly concentrated and the dominant shareholders almost complete control over the selection of directors thus they may exert exclusive impacts on both the boards and the management.⁵⁴ From this aspect, China is more similar to the UK. Despite diverse ownership distribution structures, the significant but non-controlling shareholders achieve a coalition which reaches a certain level of monitoring to management,⁵⁵ generating likewise effects of that of Chinese controlling shareholders.

Otherwise, in the UK, the non-executive directors owe the same basic duties to the company as the executive directors. However, they are held to different standards of care according to their function, knowledge, skill and

⁴⁷ See Davis, *supra* note 43, at 21.

⁴⁸ Gu Gongyun (顾功耘), *Lun Woguo Jianli Duli Dongshi Zhidu de Jige Falv Wenti* (论我国建立独立董事制度的几个法律问题) [*On the Legal Problems of Establishing Independent Director System in Our Country*], *ZHONGGUO FAXUE* (中国法学) [CHINA LEGAL SCIENCE] 65, 67 (2001).

⁴⁹ Kong Xiang (孔翔), *Zhongwai Duli Dongshi Zhidu Bijiao Yanjiu* (中外独立董事制度比较研究) [*Comparative Study of Independent Director System Between China and Foreign Countries*], *GUANLI SHIJIE* (管理世界) [JOURNAL OF MANAGEMENT WORLD] 88, 91(2002).

⁵⁰ See Davis, *supra* note 43, at 33.

⁵¹ E. B. Rock, *Adapting to the New Shareholder-Centric Reality*, Vol. 161, No. 7, University of Pennsylvania Law Review, 1907, 1978(2013).

⁵² P. L. DAVIES et al., *PRINCIPLES OF MODERN COMPANY LAW* 436 (Paul Davies et al. 9th edn., 2012).

⁵³ Paul Davies, *Shareholders in the United Kingdom*, 280/2015, ECGI Law Series, 1, 1-2(2015).

⁵⁴ Fan Lin (范林), *Zhongying Duli Dongshi Zhidu de Bijiao he Qishi* (中英独立董事制度的比较和启示) [*The Comparison of Independent Directors Between China and United Kingdom*], *HUADONG ZHENGFA DAXUE* (华东政法大学) [EAST CHINA UNIVERSITY OF POLITICAL SCIENCE AND LAW] 1, 20 (2014).

⁵⁵ See *supra* text accompanying note 53, at 26.

experience.⁵⁶ In China, there is no clear distinction between the responsibility of independent directors and other directors, except the misrepresentation exemption provision from Article 16 of *Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market*.

All in all, although there are differences, the independent directors of the two countries have some homogeneity, which makes the countermeasures of the UK are more suitable to be used for reference in our country.

2. Inspiration

a. Minority-Election Rule As discussed above, the shareholders in both countries have significant influence to the governance, hence the director election regime of the UK can provide us with feasible reference. Under the UK regime, the appointment of independent directors requires not only a majority of the votes cast at the meeting but also a majority-of-minority shareholder,⁵⁷ namely the minority-election rule,⁵⁸ which can be contemplated as revision for the Chinese regime to effectively promote the protection of minority shareholders and independence of independent director without radical changes to the ownership structure. We are glad to see that the cumulative voting for independent directors and disclosure of the voting situation of minority shareholders have been added in the latest modification, and these schemes indeed theoretically benefit the minority shareholders. But a better effect can be reached by applying minority-election rule than cumulative voting, for the former can balance public investor protection against controller right and combine with a regime that assigns particular tasks to enhanced-independence director.⁵⁹

b. Capacity of independence In the UK, some scholars also argue that independence is insufficient to guarantee good monitoring, and there is a recent shift in the UK from the focus on independence to competence and experience.⁶⁰ From the empirical respect, despite some inconsistent outcomes, there are many researches are demonstrating that the listed companies do not obviously benefit from involving independent directors on boards or too much independence, surprisingly, brings adverse effects.⁶¹ For example, the study of Bhagat & Black in 1999 showcases that there is a negative correlation between board independence and performance, thus

⁵⁶Simon Witney, *Corporate Opportunities Law and the Non-executive Director*, Vol. 16, No. 1, *Journal of Corporate Law Studies*, 145, 146 (2016).

⁵⁷Listing Rules (Listing Regime Enhancements) Instrument 2014, FCA 2014/33, at 21-22.

⁵⁸Lucian A. Bebchuk, *Independent Directors and Controlling Shareholders*, Vol. 165, No. 6, *University of Pennsylvania Law Review*, 1271, 1295(2017).

⁵⁹*Id.*, at 1302-03.

⁶⁰*See supra* text accompanying note 44, at 34.

⁶¹*See supra* text accompanying note 44, at 32-33.

recommending greater share ownership to independent directors.⁶² But the problem is the definition of independence here is ambiguous.

Then according to the study by Suzanne & George, there are four core aspects collectively leading to substantive independence of independent directors, involving structural barriers, capacity, status and power.⁶³ Compared with Australia and the US, the UK, with more inclined to enhance capacity⁶⁴ and comprehensive understanding of substantive independence, is less likely to undermine the effectiveness of independent directors.⁶⁵ Therefore, drawing on this model, we can further divide the general ‘independence’ into more precise dimensions to analyze its actual impacts. Plausibly, it is their inner abilities to participate in management without susceptibility instead of solely external requirements for independence that activate the function of independent directors.

As mentioned above, the mixed role is also an existing problem of independent directors in China and one of the reasons behind is our inadequate and poorly theorised understanding of independence. In the latest rule, there is a trend that the management of independent director is reinforced and the exclusion rules of independence are scrutinized and revised. Currently, boosting the independence of independent directors is still elucidated as an emphasis. Still, it remains in ‘structural barriers’ dimension with endeavor to construct external walls by formal rules to avoid inappropriate influence.⁶⁶ But more fundamentally, the intrinsic capacity of them is ignored. And the alleged ‘capacity’ is linked more to their management responsibility other than ‘independence’ in Chinese current context.⁶⁷ As I consent the wisdom from sceptics that independence and expertise are mutually exclusive,⁶⁸ it is likely that shortly we will encounter the dilemma if we do not clarify the direction between these two. Therefore, since the function of mere independence has been proved ineffective in the British market, we may conclude that a better way to fix this is to strengthen management responsibilities from expertise and skills rather than maintain the stress on independence.

c. Supervisory duty and management duty Furthermore, we should prevent independent directors from transforming into another group of executive directors. Other scholars in the UK points out that the treatment of non-executive directors in Higgs Report, though primarily been implemented, is flawed. Following the Higgs report, namely focusing on both monitoring executive activity and contributing to the development of

⁶²Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, Vol. 54, No. 3, The Business Lawyer, 921, 952-53 (1999).

⁶³Suzanne Le Mire & George Gilligan, *Independence and Independent Company*, Vol 13, No 2, Journal of Corporate Law Studies, 443, 458-59(2013).

⁶⁴See supra text accompanying note 45, at 12. This principal is consistent with Suzanne’s definition of ‘capacity’, namely the internal ability to protect the independent thought and action from inappropriate influences, rather than the external walls created by criteria in rules as structural barriers.

⁶⁵See supra text accompanying note 63, at 474-75.

⁶⁶See supra text accompanying note 63, at 450-51.

⁶⁷Currently, ‘independence’ in Chinese context mainly refers to sole ‘structural barriers’ mentioned above.

⁶⁸Suzanne Le Mire, *Independent Directors: Partnering Expertise with Independence*, Vol 16, No 1, Journal of Corporate Law Studies, 1, 1(2016).

strategy,⁶⁹ the role of non-executive directors remains mixed and unfocused. A plan for this is that independent non-executive directors should act essentially as monitors within a company, controlling whatever possible conflicts of duty and interest the company's executive directors may have rather than as participants in management at the same time.⁷⁰ The vital divisions here are supervisory duty and management duty. The reasons for the division include the doubt of performing both duties well and the nature of short-term involvement.⁷¹

It is indeed reasonable to concentrate more on supervisory duty than management, however, we should keep in mind that the two duties are mutual reinforcing, as only if the independent directors are embedded more in the management, can they enhance the abilities and deterrent impacts as a supervisory power. In turns, the role as strong supervisors prompts their influence on the board and the management in determination. It is innocuous to develop these duties simultaneously, but tactically, emphasizing one positively to bring about improvement for the other can be judicious. More attention paid on management side, hence, is feasible, due to more specific measures and criteria befitting to apply than the supervision side. Then, the division of rights and responsibilities between executive and independent directors still needs further analysis and research.

IV. CONCLUSION

After an exploration of approximately 20 years, we finally established an orderly system of independent directors. In the past two years, our regulation has been more up-to-date and of higher quality, which shows a good sign for further development. Remarkably, the latest *Measures for the Administration of Independent Directors of Listed Companies* made significant modifications to the appointment, execution, and responsibility of independent directors, and added more mechanisms to reestablish their role, leaving us with great expectations to its effects. However, we cannot ignore the functional orientation of independent directors. Since the shareholders' influence and the role of independent directors of China and the UK are, to some extent, homogeneous, there is possibility that we can learn from the previous experience of the UK and take measures to avoid the crossroad in advance. Though the specific methods of applying minority-election rule, converting the stress on independence to the skills and abilities or stressing the management function need further research, it is critical to clarify the core function of independent directors' role in current moment.

⁶⁹Derek Higgs et al., REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS, 21, (Great Britain. Department of Trade and Industry eds., 2002).

⁷⁰Richard C. Nolan, *The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors following the Higgs Report*, 6 Theoretical Inquiries in Law 413, 461-62(2005).

⁷¹*Id.* at 440-41.