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4 December 2014

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Corporate and Investment Communications Department
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Dear Sirs

HKIoD's Response to HKEx on Concept Paper on Weighted Voting Rights (August 2014)

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

With best regards

Yours sincerely
The Hong Kong Institute of Directors

Dr Carlye Tsui
Chief Executive Officer

cc: Mr Henry Lai, Chairman of Council, HKIoD & Chairman,
Corporate Governance Policies Committee

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Concept Paper on Weighted Voting Rights (August 2014)

In relation to the captioned Concept Paper, The Hong Kong Institute of Directors wishes to present the following views and comments.

General comments

Although there is substantial voice among our membership against the idea, HKIoD believes there are circumstances in which companies should be allowed to use WVR structures.

The use of WVR structures, however, should not result in undue risks to investors. They should not disenfranchise existing shareholders. They should also not be permanent fixtures in the issuer's corporate governance. Stemming from these principles, we have a preference for allowing only new applicants to list with WVR structures, and there must be a policy to require the WVR structures so permitted to be stripped away eventually.

Is prohibition necessary for investor protection?

Investor protection is an often cited reason for not favouring WVR structures. Nonetheless, a reasonable – certainly not irrational – postulation is that prohibiting WVR may not be all that necessary for investor protection, and it may in fact hurt market efficiency.

WVR structures are not favoured because they are seen as an affront to the “one share, one vote” concept, which is in turn seen as the essential foundation for fair and equal treatment of shareholders. But what is the real effect of “one share, one vote” when many listed companies in Hong Kong are already rather closely controlled (because they are family-owned businesses, or are state-owned enterprises)? After all, only 25% public float is required for a listing in the Hong Kong market. And even for companies that are more widely-held on paper, there are plenty other means of preserving control (e.g., voting agreements). As the Concept Paper noted in para 75 (citing an OECD report), it is not efficient to ban all measures that seek to separate ownership and control.

WVR structures will work to make ordinary shareholding count for less, but they do not tend to outright prevent a shareholder without the special voting power to actually “vote”. The issue is not so much about lack of representation, but the practical effect of such shareholder having “no hope of winning”. The treatment is not equal with respect to those shareholder(s) with superior voting power, for sure. But fairness is still there, if an investor buys in with knowledge of the WVR structure and no pre-existing rights of that investor are restricted or reduced. This is not an unlikely scenario if only new applicants are permitted to list with WVR structures. See Concept Paper para 148. Investors who buy in to such an issuer whether on listing or subsequently in the secondary market are in the same shoes, and there is equality within that class. These investors may well be buying in despite the WVR structure because there could be economic value to gain (e.g., by way of share appreciation or dividends).

Would allowing WVR structures have some effect at improving market efficiency?

WVR structures could arguably have better appeal if they can bring some tangible effect at improving market efficiency. One critique of WVR structures is that they enable an issuer's founders and existing management to continue on listing. To enable incumbent managers to continue, however, can in turn promote a long-term perspective and may well result in

substantial economic value of the firm. The Listing Rules indeed cherish the notion of management continuity.

An efficient market should enable capital to flow from investors to listed companies when investors have knowledge of what they are buying into, and when issuers have market incentives to compete for investors' capital through the signaling effect of responsible corporate governance. Putting in place sensible restrictive or "sunset" provisions to assure the eventual stripping away of WVR structures is one indication of responsible corporate governance.

Can we not help investors fend for themselves?

We should trust that investors can and will assess information and price an investment accordingly. It is not necessarily an undue risk to investors if the fact of a WVR structure is properly disclosed and investors have reasonable access to the information to consider whether to stick with the issuer.

A shareholder becoming dissatisfied down the line should at least be able to "vote with his feet". It may be that liquidity, the ability of a dissatisfied investor to exit the investment, is the more important. Companies with a high trading volume on any average day would normally be thought of as being able to provide that form of liquidity. Short of that, the presence of a "market maker" willing and able to redeem shares at quoted price might also give comfort.

In the case of abuse, disadvantaged investors ought to also have means of redress. The Concept Paper rightly mentioned class action regime as a possible solution. Some may even consider the introduction of a class action regime as prerequisite to allowing WVR structures. HKIoD believes that the ability to initiate and conduct class actions can be a useful addition to supplement the tools and options available to shareholders in protecting their rights. The prospect of facing class actions from shareholders can have the effect of prompting companies to have a stronger sense of obligation, whether to the controlling shareholder or to the minority shareholders, in their disclosure, internal control and compliance practices. But HKIoD is also mindful that the adoption of a class action regime can produce its own social problems, most notably in the well-justified fear of promoting unnecessary, unmeritorious litigation. We therefore further encourage the Exchange and all stakeholders to first look to alternative forms of collective redress; for example, a more flexible application of the group litigation order, or further evolution of the SFC's surrogate actions practice.

Is competitiveness the only concern here?

A major impetus to seriously consider whether to allow WVR structures is the race with other markets for listing in the face of global competition. We at HKIoD are for the competitiveness of the Hong Kong capital market, but we would also point out that the debate on whether to permit WVR structures is lending us a timely opportunity to have another deep look at some of the characteristics of our market. Conceivably, how those characteristics might or should change and evolve can in turn affect how we feel about WVR structures.

We mentioned that liquidity may be the more important feature or safeguard for investors. A closely related aspect of investor protection is diversification of portfolio. Protection of minority investors may have taken on extra importance in Hong Kong because of the substantially higher proportion of retail investors when compared to other markets. There is also the perception that some of our retail investors may be more in the habit of concentrating

their investments in a few bets on hot stocks of the day. This of course may not reflect the whole picture, but a rational question to ask is whether a culture of investing through mutual funds will help more individual investors achieve portfolio diversification. Will the change in investors composition (higher proportion of professional / institutional investors) diminish the abhorrence towards WVR structures (in so far as the professional / institutional investors have better bargaining power against issuers and better ability to price shares to discount the effect of WVR structures) and thereby remove the need for outright regulatory prohibition? We note that whether to have legislations to permit open-ended fund companies was the subject of a consultation earlier this year, and we believe it is worthwhile to take note of the progress in that assessment when considering whether to permit WVR structures.

For investors (retail or institutional), they will need good information to assess an issuer and to make investment decisions. Disclosure is acknowledged as the central part of the Hong Kong regulatory scheme. See Concept Paper para 70. A disclosure regime is only effective when it provides investors with the information they need to make informed investment and voting decisions, but does not overwhelm them with either extraneous information or with a form of presentation that obscures and detracts investors from what is material. We believe it is worthwhile to consider what changes, if any, needs to be made to our disclosure regime to help investors (particularly retail investors) understand the effect of WVR structures that an issuer may have adopted (or more generally, any other material matters about an issuer).

It would be remiss if the role of connected transaction rules in preventing tunneling or value-shifting is not mentioned. As reported in the Concept Paper para 68-70, the connected transaction rules we now have are given particularly high regard, and Hong Kong in fact places greater reliance on those rules to prevent abuse of control before it occurs. If WVR structures were to be allowed, however, will the connected transaction rules be put into strain? Would there be a need, if at all, to change or adjust the administration of those rules in that new environment?

The proper role and function of the board of directors cannot be ignored. One particular form of WVR is “enhanced or exclusive director election rights”. When certain shareholders have superior rights to name and install favourites to sit on the board, it does invite arguments that those nominees will only be looking after the master’s interests. We believe that, with proper initial training and continuing development, directors will come to an understanding of their role, including the recognition that the primary loyalty runs to the company regardless of who nominates them. The perceived and actual independence of directors is an important factor, and there is certainly room to bring up again the debate whether we should further raise the requirement to have a majority of INEDs. There is well-founded postulation that requiring a majority could make INEDs collectively better able to play their director roles. If we do so, there is then the need to find individuals who have the skills, knowledge and qualities to meet corporate governance demands of today to fill INED positions, not just to make up the numbers. Prospective directors should have conscientiously equipped themselves for the role, but they must also be adequately remunerated for their skills and for their time and effort.

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HKIoD will be happy to discuss and provide further views on any part of this Response or issues that are, per para 53, outside the scope of the Concept Paper.

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Responses to specific questions

Subject to our general comments above, we state our responses to specific questions as set out in the Concept Paper as follows:-

Question 1: Should the Exchange in no circumstances allow companies to use WVR structures? Please give reasons for your views.

HKIoD Response:

- We believe there are circumstances in which companies should be allowed to use WVR structures.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

Question 2: Should the Exchange permit WVR structures:

- (a) for all companies, including existing listed companies; or
- (b) only for new applicants (see paragraphs 147 to 152); or
- (c) only for:
 - (i) companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162), please specify which industries and how we should define such companies;
 - (ii) “innovative” companies (see paragraphs 163 to 164), please specify how we should define such companies; or
 - (iii) companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons.
- (d) only in “exceptional circumstances” as permitted by current Listing Rule 8.11 (see paragraph 81) and, if so, please give examples.

Please give reasons for your views.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

HKIoD Response:

- As to (a) and (b), we have a stronger preference for allowing only new applicants to list with WVR structures. The rationale is for the most part as stated in Concept Paper para 147-150.
 - Allowing only new applicants would mean as corollary that existing listed companies should not be permitted to adopt WVR structures. There is then the possibility of circumvention or end runs that may call for anti-avoidance provisions. See Concept Paper para 151-152. But if an existing listed company is eager to adopt WVR structures and in fact tries to achieve it by de-listing or spin-offs, such actions will have to be disclosed and proceed in accordance with prevailing rules. Investors will still have opportunities to exit and look for better investment prospect elsewhere if dissatisfied, but they may find it agreeable and decide to stick with the issuer (and its progeny). Market forces could still be a potent restraint. The more important safeguard is to have a policy to require some restrictive or “sunset” provisions that will lead to the eventual stripping away of WVR structures once permitted. As we note

elsewhere in this Response, we do not believe it is necessary to impose mandatory forms of restrictions, but should rather leave such matters where they belong – in the domain of corporate governance – for issuers to deal with in accordance with their own particular circumstances.

- As to (c)(i), we do not believe it is practical nor productive to limit the application to particular industries because, as reported in Concept Paper para 158-159, there seems to be no definite connection between companies opting for WVR structures and the industries to which they might belong or businesses they might engage in.
- As to (c)(ii), we do not believe it is practical to limit the application to “innovative companies” because “innovative” is itself an elusive concept. New applicants boasting advanced technology when they seek a listing may soon find themselves playing catch-up. An existing listed company with a long history could also come up with game-changing innovations.
- As to (c)(iii), we believe it is more useful to delineate and articulate the principles that will justify allowing issuers to have WVR structures rather than focusing on mechanical pre-determined characteristics.
- As to (d), we note that, LR 8.11 thus far has not led to WVR structures being allowed (see Concept Paper para 10). We believe that there are circumstances in which companies should be allowed to use WVR structures subject to certain principles discussed in this Response. Those principles could conceivably form the backbone of a new policy behind the interpretation of LR 8.11 insofar as the meaning of “exceptional circumstances” is concerned. Nonetheless, if the consensus is to allow WVR structures, we would prefer a casting of the principles that would justify WVR structures separate and away from the more confined context of LR 8.11 “exceptional circumstances” in order to better sound off the change in policy. The LR 8.11 “exceptional circumstances” mechanism can still be preserved to give the Listing Committee some further leeway and discretion to handle extraordinary cases.

Question 3: If a listed company has a dual-class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views.

HKIoD Response:

- We tend to believe that even issuers who had reasons to adopt a WVR structure on listing will have plenty of reasons for marketing purposes to put in place restrictive or “sunset” provisions to assure the eventual stripping away of the WVR structure. So long as the essential information is disclosed, investors should and will have the basis to assess the situation and price the investment accordingly. And therefore, we do not believe it is necessary to impose mandatory forms of restrictions, but should rather leave such matters where they belong – in the domain of corporate governance – for issuers to deal with in accordance with their own particular circumstances.

Question 4: Should other WVR structures be permissible (see Chapter 5 for examples), and, if so, which ones and under what circumstances? Please give reasons for your views. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

HKIoD Response:

- We believe it is more useful to delineate and articulate the principles that will justify allowing issuers to have WVR structures than to enumerate the specific structures that should be allowed.

Question 5: Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V)? If so, please specify these changes with reasons.

HKIoD Response:

- The focus of this consultation question appears to be on whether investors will have sufficient channels to have post-event means of redress if there is abuse. We respond accordingly.
 - HKIoD believes that the ability to initiate and conduct class actions can be a useful addition to supplement the tools and options available to shareholders in protecting their rights. The prospect of facing class actions from shareholders can have the effect of prompting companies to have a stronger sense of obligation, whether to the controlling shareholder or to the minority shareholders, in their disclosure, internal control and compliance practices. But HKIoD is also mindful that the adoption of a class action regime can produce its own social problems, most notably in the well-justified fear of promoting unnecessary, unmeritorious litigation.
 - We therefore further encourage the Exchange and all stakeholders to first look to alternative forms of collective redress.
- See also our general comments on other aspects of the corporate governance and regulatory framework.

Question 6: Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of this paper:

- (a) using GEM, a separate board, or a professional board to list companies with WVR structures (see paragraphs 33 to 41); and GEM Rule 11.25.
- (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47)?

HKIoD Response:

- As to (a), we do not believe issuers adopting WVR structures should be confined to a separate board. Liquidity usually suffers when listed on a second board, which will make it less easy for dissatisfied investors to exit. To the extent we want to attract some of the better more innovative companies which may have good reason to preserve certain WVR structures, confining them to a separate, seen-as-second-rate board could cause unnecessary stigma to be counter-productive.
- As to (b), we do not believe issuers should be treated differently for purpose of WVR structures just by whether they are domestic or from overseas. This is certainly the case for primary listings.
 - For secondary listings, however, if the applicant is already listed in a market with credible regulatory standards, and investors have reasonably easy access to information about that applicant, our market should have more reason to

accommodate. It may be helpful to designate a list of such markets with credible regulatory standards.

Question 7: Do you have any other comments or suggestions regarding WVR structures?

HKIoD Response:

- See our general comments.

<END>