

members' comments re the FSDC paper "Positioning Hong Kong as an International IPO Centre of Choice" – November 2014

Shareholding structure/voting right

member fund companies generally do not support companies that have share classes with different voting rights.

- Corporate governance structure is key and high standards of corporate governance should be maintained. This is important and underpins the fiduciary duties of investment managers.
- Member firms have reservations regarding the comments on the potential loosening of the regulatory standards in Hong Kong. Companies are attracted to list in Hong Kong because of its strong and robust regulatory regime and generally high levels of corporate governance. This signalling mechanism displays to investors their commitment to good corporate governance. Any diminution of these regulatory standards would not serve to attract quality companies to Hong Kong.
- Loosening of regulatory standards could put the HK market at risk of attracting lower quality companies with higher probability of default and corporate governance related controversies. This could impact HK's reputation negatively and results in Hong Kong losing out in the competition with other markets. There's a trend to improve corporate governance practices in other markets as indicated by the launch of the stewardship codes in the UK, Malaysia and Japan. The high sign-up rate by investors to the codes is testament to the commitment to corporate governance amongst investors.
- Our members have concerns about the spirit that underlies section 4.9, which appears to suggest that regulators should consider allowing listings of companies with non-typical, common-law based corporate structures. The document rightly notes that the "one share one vote" concept ...[is]... often regarded as a cornerstone of shareholders' protection under common law". Members generally believe in the sanctity of one-share-one-vote, and that ownership interests should be proportionate to economic interests. Allowing an individual or entity disproportionate control over an organisation is fundamentally not in the best interests of other shareholders, and members urge caution on this issue.
- It is understandable that some quarters are generally disappointed that HK "lost" the Alibaba business, and presumably it would have brought more liquidity. But the authorities in HK do the right thing by rejecting the proposed ownership structure. One share, one vote is a simple, clean and fair rule. As an investor, if a fund manager takes a stake in a company on behalf of its clients, the manager also wishes the rights that go with that. Most of the clients of fund managers would want the same. Some companies say that they need to preserve unusual voting structures because that is the only way they can ensure proper management of their companies. But they can't have both sides. If a company wishes to reap the benefits of listing (e.g., access to capital), it has to accept the responsibilities that come with listing. If one wants to own a car, he/she needs to obey the road rules. Just because there are some unusual designs of the car doesn't mean one can have a separate set of rules that only apply to him or her.



“One size fits all” market

- The paper has some discussions about possibly segmenting the market (e.g. creating something like a GEM board for smaller companies). The experience of Shenzhen (which does have a GEM board) is that it is highly volatile, given to big swings, generally overpriced and not a high-quality market for investors. As such, managers don't see any compelling reasons for Hong Kong to launch something similar.
- Members do not agree with the observation made in section 4.7.2 around levels of compliance vis-à-vis an institutional investor shareholder base. Whilst institutional investors do, by virtue of their role in the market, have access to deeper market infrastructure and resources, they do not have access to non-public information.

Whilst institutional investors are by nature determined to manage investment risks on an ex-ante basis, they are only able to do so because of the very comprehensive regulatory framework around compliance, disclosure, and corporate governance. Diluting this framework, in the belief that institutional investors would still be able to manage risk by virtue of their size, is misguided and potentially detrimental to the interests of the institutional investors and ultimately to their underlying investors.

Shareholders' recourse

- The public filing rules are important. There should be a systemic approach for shareholder recourse actions that could help promote corporate governance and improve the self-imposed discipline for IPO advisors (lawyers/investment bankers) and corporates both before and after listing. It is also important to establish a system to reduce/compensate the losses incurred by manipulative/distorting sell-side reports or misbehavior of less regulated investors (e.g. certain hedge funds).
- Section 4.4.4 stated that “giving shareholders more tools to enforce their own rights will likely remove the need for much of the current front-end regulatory scrutiny of overseas issuers”. Managers generally do not agree with this proposition: even though globally, there has been increasing focus around more due diligence ahead of IPO, more rigorous work on the quality of prospectuses, and more regulatory scrutiny of companies; managers believe that removing the ex-ante front-end work of a regulator through a belief that investors are able to adequately and proportionately seek recompense on an ex-post basis is misguided.

Other comments

- IPO process: re mandatory retail offer component, some members opine that the HK system is rather prescriptive - other markets do not have such a rigid mechanism to ensure retail participation in IPOs. They suggest the authorities may consider relaxing the requirements to reduce the part of IPO that is being reserved for retail investors.
- The potential for a scripless holding system for listed securities would be welcomed.
- More international enforcement cooperation will be positive for investors and can help create a level playing field globally and contain free riders.
- The paper is written from the perspective of how to attract more foreign companies to list in HK, and how to better diversify the sector mix in the HK market. Some members point out that they don't believe that these should be goals for the market – as fund managers can already invest in foreign companies in their “home” markets, and diversify sector biases across multiple geographies. In any event, most fund managers do not run pure HK portfolios.

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