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Dear Sir/Madam

HKEX Consultation Paper on Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers

We refer to the captioned consultation paper and would respectfully request the HKEX to consider our views.

With respect to the captioned consultation, **we have major concerns about the proposal to remove the class meeting requirement for A/H shareholders.** Under the current requirement, separate class meetings of domestic shareholders and H shareholders are required when a PRC issuer proposes to vary or abrogate the rights attached specifically to one particular class of shareholders. This has been a fundamental mechanism to protect the interests of H shareholders since 1993. It has allowed H shareholders who are invariably minority shareholders to have an effective channel to express their views on significant capital decisions by the issuers.

Many of our members are taken aback when they note that this mechanism will be repealed; and furthermore, without full market consultation. Even though the Paper is branded as a consultation paper, the HKEX indicates that "*given the amendments are consequential, a market consultation is not required.*" Whilst technically speaking, this may be valid; we wish to stress that the changes go far beyond the technical level – it is tantamount to a policy change. We are deeply concerned that such a fundamental change can be brought to the market in such an understated manner.

The repeal of class meetings requirement for A/H shareholders has major negative implications to the interests of H shareholders. And here we are referring not only to international investors; but Hong Kong shareholders as well. They span the whole spectrum – from direct retail shareholders to indirect ones that invest through funds and other vehicles; from pensions (such as MPF/ORSO) to other institutional investors. More importantly, with the launch of the Stock Connect, the investor base has broadened up to include mainland investors.

Why should the class meetings be maintained?

- A shares and H shares are not fungible and are subject to different regulatory regimes.
- In the guidance issued by the SFC on March 17, SFC provides explanation as to why separate treatment for A shares and H shares are justified in certain cases.

> *"Given the inherent differences in the trading prices and currencies of, and the markets for, A shares and H shares of PRC H Share Issuers, and the fact that A shares and H shares are not directly fungible, the practice of treating A shares, H shares and other equity securities of a PRC H Share Issuer separately will remain after the PRC Rule Change."*

This succinctly captures the key differences between the two classes. There are other points in the Guide that fully resonate with our views:

> *"As any proposal to privatise or delist H shares will significantly impact holders of H shares and their interests are considered to be materially different compared to holders of domestic shares (whether unlisted or A shares), the Executive considers that holders of H shares should continue to benefit from the protection that it had prior to the PRC Rule Change. Accordingly, any approvals under Rules 2.2 and 2.10 should be decided by holders of H shares only."*

The gist of the issue is that if the authorities are fully aware of the structural differences, why should we proceed to deem the two classes as one? Why would the differences only warrant separate treatments in privatisation or delisting? Shouldn't the rationale be equally applicable to other scenarios in the whole lifecycle? Wouldn't the interests of holders of H shares be materially different from holders of domestic shares and be significantly impacted in other scenarios that affect capital management? Why only on exit?

Suffice to say, based on past experiences, it is not uncommon that proposals relating to capital management, such as rights issue, sales repurchase and dividend policy, affect the interests of A shareholders and H shareholders differently. And as the differences continue, we do not find any compelling reasons why we should change the approach now, i.e. to treat A and H shares as the same. To enable the respective cohorts to effectively express their views and assert their rights, separate voting and approval by each group is pivotal.

The authorities have always stressed that front and centre is investor protection. H shares have a large HK investor base – including inter alia, local retail shareholders, fund investors, MPF/ORSO employees and other pensions). On top, many international investors and increasingly mainland investors have exposure to H shares. And as the removal would impair the ability of holders of H shares - which are invariably minority shareholders - to protect their rights, how would this dovetail with the remit of investor protection?

Furthermore, high on the regulatory agenda is ESG. The authorities have stressed the importance of engagement in driving investee companies' sustainability and sharpening positive corporate behaviour. They also point out that fund managers play an important role in influencing investee companies' actions and improving the quality of ESG-related disclosures. To effectively engage and achieve impacts, managers need the mechanisms and tools that support and facilitate engagement. However, the proposed repeal militates against this objective – it would just undermine, rather than support, managers' ability to engage.

Isn't it that the class meetings tip in favor of H shareholders?

Even though it seems that relatively speaking, there is greater reliance by H shareholders on class meetings to exercise their rights; the value of the class meetings is equally relevant to both A and H-share investors.

Cases abound where the interests of H shareholders and domestic shareholders diverge in relation to particular proposals. It is not uncommon that a proposal may benefit one group of shareholders over the other. Hence class meetings are necessary to avoid unfair treatment to a particular group of shareholders.

Generally, controlling shareholders have most of their holdings in A shares, class meeting is the top avenue for H shareholders to articulate their views, in particular, concerns about sub-optimal proposals. For example, in cases where issuance price was set at a price above H-share market price. This will leave no incentives for H shareholders to participate in the issuance, while A shareholders could subscribe new shares at a deep discount to the price of the A-share. If the issuance price was at a discount to book value, H shareholders as a group would be forced into dilution of book value per shares as a result. We must remember that even today, H shares generally remain at a substantial discount to A shares.

On the other hand, there are instances where the proposal may tip in favor of the H shareholders. For instance, in spin-off, H shareholders are entitled to pre-emptive rights to subscribe shares of the spun-off entity, while A shareholders are not entitled to such. Subjecting these proposals to class meeting approval would allow A-shareholders to voice their concerns and redress the unfairness.

The divergence of interest is also evident in other areas, such as dividend and bonus shares. Both cash dividend and bonus shares typically entail different patterns of distribution of value: e.g. if an issuer chooses to offer bonus shares in lieu of dividends, there is no discount in cash distribution of dividends; but a discounted value of the traded shares if received in a bonus issue for H shareholders.

Upon removal of the class meeting requirements, both A and H shareholders are stripped of an effective means to prevent proposals that they deem as unfair.

If the class meeting is maintained, won't it affect the attractiveness of the HK share market?

One may argue that if the HKEX does not go ahead with the repeal, it will undermine the attractiveness of Hong Kong to H-share issuers. We submit that having to host two meetings would involve more work; and may give rise to more uncertainties in the voting outcomes. Also, it may be deemed as unfair to A-share investors as it gives H-shares investors a disproportionate say relative to their shareholdings.

However, we believe that to H-share issuers, the ability to broaden their investor base, to access a diverse and deep pool of investors and to be subjected to higher corporate governance standards will only bolster their ability to attract quality long-term capital. This is also in line with a key objective of the mainland authorities.

In fact, by flagging the proposed amendment, the authorities are already undermining the attractiveness of the H-share market to international investors. We understand that some have started to review the overall value proposition of H-shares. Many overseas shareholders have invested in H shares on the assumption that their interests can be protected via the class meeting requirement. But with this major change, some have started to re-evaluate the risk profile and liquidity of H-shares. There are concerns as to how the change would affect behaviour and the dynamics of the relationship between the issuer and investors. Very often, H-share issuers would consider non-financial factors on top of the financial ones; and the priorities can at times, be very different from those set by the financial investors. As fiduciaries, fund managers are obliged to act in the best interests of investors; and in making investment decisions, financial and economic considerations should always prevail. With the removal of class meetings, an immediate question is that if the interests are not aligned, which is not uncommon, what tools or means can H share investors tap on to ensure that their views are heard and be taken into account? Without this tool, what mechanisms can investors rely on to ensure accountability by the Board/management of the issuers? Some have expressed concerns that the removal of class meetings will further weaken the accountability of issuers to minority shareholders, which has never been easy.

The impending amendment will only weaken the governance structure. This development is not going to benefit the HKEX and more broadly, the position and reputation of the HK stock market.

<u>What do we hope to see?</u>

- We would strongly exhort the HKEX to maintain the class meetings. The class meetings are a lynchpin of investor protection.
- If the authorities maintain that they would go ahead with the proposal, we would suggest that at least H shareholders should have a say in the transition, i.e. an issuer should submit amendments to its articles of association for the removal of class meeting requirements for approvals by A shareholders and H shareholders at separate class meetings. Only if the removal is approved by both classes of investors can it come into effect.
- If both classes of investors approve the removal of class meetings, there should be additional scenarios where class meetings would be allowed - instead of just restricting to delisting or privatization. Investors need protection throughout the lifecycle. Furthermore, issuers should publish the voting results of A shareholders and H shareholders separately. And if the issuers were to proceed with a proposal that had been blocked by either group of shareholders, they should provide a statement detailing why a particular

class of investors has objected to the proposal and why this proposal is in the interests of all shareholders.

- Currently, there is no Reciprocal Arrangement between Hong Kong and the mainland for judgments dealing with disputes involving H shareholders and arising from a PRC issuer's articles of association or the PRC Company Law, such that a shareholder who obtains a judgement from a Hong Kong court cannot directly apply to the mainland (the place of incorporation) court for enforcing the Hong Kong judgment. We would suggest that the claimant should have the discretion to settle by arbitration such disputes in either Hong Kong or the mainland.

This is a very important topic for the future development of the Hong Kong stock market, and we would strongly exhort the HKEX to reach out to the investor groups (both locally and internationally) to understand their perspectives and consider the ramifications before finalising the decisions. We would welcome the opportunities to discuss our concerns in greater details.

Your sincerely

CEO