Weighted Voting Rights Concept Paper

29 August 2014

David Graham *Chief Regulatory Officer and Head of Listing*

Outline of Presentation

1. Purpose
2. History
3. Structure
4. Questions
5. Next Steps
6. Q&A

Purpose

The Exchange today publishes a Concept Paper on Weighted Voting Rights

- A “Concept Paper” because it:
  - does **not** advocate the status quo or a change
  - does **not** contain any specific Listing Rule changes for consultation
  - seeks views on the **concept** of Weighted Voting Right structure
- The Concept Paper:
  - asks whether Weighted Voting Right structures[1] should be permissible for companies listed or seeking to list on the Exchange’s markets
  - aims to promote an informed, focused and coherent discussion
  - is intended to be a neutral, factual and analytical presentation of the relevant issues and considerations

The Exchange has formed no view for or against Weighted Voting Rights

1. *Governance structures that give certain persons voting power or other related rights disproportionate to their shareholding*

History

Reasons for Publishing the Concept Paper

- The Listing Rules should "*reflect currently acceptable standards in the market place*"[2]
- Almost 25 years have passed since the restriction on Weighted Voting Right structures was included in the Listing Rules[3] (December 1989)
- The Exchange has received a number of enquiries from participants in the market (both during and prior to 2013) on the acceptability of Weighted Voting Right structures
- The FSDC[4] recently commented that "… *the 'one share one vote' concept may be studied in more detail and re-considered with the benefit of public consultation."*

The Exchange considers that there is sufficient merit in a comprehensive public debate in Hong Kong on the subject of Weighted Voting Rights

2. *Main Board Listing Rule 2.03*
3. *Main Board Listing Rule 8.11*
4. *The Financial Services Development Council, established by the Hong Kong SAR Government in January 2013.*

Structure

Structure of the Concept Paper

- Chapter 1: Investor Protection
- Chapter 2: Current Hong Kong Position
- Chapter 3: Competitiveness of Hong Kong
- Chapter 4: Jurisdictional Comparison and Empirical Studies
- Chapter 5: Other Weighted Voting Right structures in Use
- Chapter 6: Additional Considerations
- Chapter 7: Questions
- Appendices include:
  - Jurisdictional Comparison and Empirical Studies – the product of extensive and comprehensive research – important background information to the Concept Paper

Structure

Other Considerations

- The Concept Paper does **not** seek **specific** views on:
  - The re-positioning of Growth Enterprise Market (GEM)
  - The creation of a professional (or other) board for companies with Weighted Voting Right structures
  - Whether Chinese companies should be permitted to secondary list on the Exchange[5]
  - Whether overseas companies should be able to list with Weighted Voting Right structures
- The above would require a separate consultation but the Exchange will take note of any views that respondents may wish to submit

5. *See Joint Policy Statement Regarding the Listing of Overseas Companies, (September 2013), paragraphs 88(c) and 94*

Structure

Chapter 1 - Investor Protection

- The fair and equal treatment of shareholders is a general principle of the Listing Rules[6]
- New applicants and listed companies must ensure the voting power of their shares bears a "reasonable relationship" to the equity interest of those shares
- This can align controlling shareholders' interests with other shareholders and make it possible for incumbent managers to be removed, if they underperform
- The World Bank ranks Hong Kong **third** and the US **sixth** on investor protection
- US exchanges allow companies to list with Weighted Voting Right structures. This is in the context of a different regulatory and legal regime to Hong Kong (e.g. class actions in the US)

6. *Main Board Listing Rule 2.03(4), GEM Listing Rule 2.06(4)*

Structure

Chapter 2 - Current Hong Kong Position

- The Companies Ordinance (Cap 622) allows companies to issue shares carrying more (or less) than one vote per share (if the company's articles of association permit)
- The Listing Rules do not allow listing applicants or listed companies to use Weighted Voting Right structures other than in "exceptional circumstances" agreed with the Exchange[7]
- The Exchange has not listed any company using this exception

7. *Main Board Listing Rule 8.11, GEM Listing Rule 11.25*

Structure

Chapter 3 - Competitiveness of Hong Kong

- **Hong Kong as an International Financial Centre**
  - Hong Kong has successfully established itself as an International Financial Centre and a leading venue for the listing of shares

  "…it is important that China should have an international financial centre of global significance, and one that is comparable to New York and London in terms of scale and scope of its financial services and instruments offered."[8]

- **Competition for Mainland Chinese Company Listings:**
  - As at 31 May 2014, **102** Mainland Chinese companies were primary listed in the US (on NYSE or NASDAQ) rather than in Hong Kong
  - Almost a third (**29%**) have a Weighted Voting Right structure, and this is becoming increasingly common
  - This third represents **70%** of the market capitalisation of all US listed Mainland Chinese companies

8. *Conclusions of the Financial Services Action Group established by the Government in 2006.*

Structure

Chapter 3 - Competitiveness of Hong Kong (continued)

- **Competition for International Listings:**
  - FSDC: "*Hong Kong is at risk of over-reliance on Mainland China as the source of its IPO candidates.*"[9]
  - Shanghai-Hong Kong Stock Connect may fundamentally alter Hong Kong's attractiveness as a listing venue of overseas companies
  - Companies with dual-class share structures represent 14% of the total market capitalisation of all large US listed companies[10] (e.g. Google, Facebook, Visa and Mastercard)

9. Conclusions of the Financial Services Development Council.
10. US headquartered companies primary listed on NYSE or NASDAQ with a market capitalisation greater than US$2billion. Excludes investment vehicles, private limited partnerships and limited liability companies.

Structure

Chapter 4 - Jurisdictional Comparison

- The Exchange conducted an extensive and comprehensive review of practices in overseas jurisdictions
- A detailed description of the approach taken in **14** jurisdictions is set out in Appendix III to the Concept Paper
- Practice varies:
  - Some have permissive regimes (e.g. US, Canada and Sweden)
  - Some prohibit in law (e.g. Germany, Spain and Mainland China)
  - Some allow unlisted companies to use Weighted Voting Right structures but prohibit them for listed companies (e.g. Hong Kong, Australia, Singapore and the UK – for “premium” listed companies)

Structure

Chapter 4 - Empirical Studies

- The Exchange conducted an in-depth review of the academic literature on the impact of dual-class share structures (see Appendix IV to the Concept Paper)
- The empirical studies are inconclusive. (there is evidence of under-performance, neutral performance and out-performance)
- There is a consensus view that investors generally apply a discount to shares with inferior voting rights in a dual-class share structure
- The studies argue this reflects the risks of the consumption of private benefits by controllers, management underperformance and entrenchment
- There is a lack of consensus as to whether these risks actually result in a negative impact on a company's performance

Structure

Chapter 5 - Other Weighted Voting Right Structures in Use

- In the US, “dual-class shares” are the most common Weighted Voting Right Structure:
  - two share classes (“A” and “B” shares) where one class carries a greater number (most commonly 10) votes per share
- Variations exist:
  - Most common variation - a right to appoint directors, usually a majority, to the board
  - Board appointment rights usually carried by shares but can be purely contractual (e.g. Autohome, Inc - board appointment rights in its articles)

Structure

Chapter 6 - Additional Considerations

- Possible restriction to new applicants:
  - Standing Committee on Company Law Reform recommended, in 1987, if "B" shares permitted in "exceptional circumstances" this should only be when a company was **first** listed - when it would have no public shareholders
  - NYSE and NASDAQ restrict the use of Weighted Voting Right structures to new applicants
- Possible restriction to "information technology" companies:
  - The majority (70%) of US listed Mainland companies with Weighted Voting Right structures are IT companies
  - However, in the US, companies in many industries use dual-class share structures

Structure

Chapter 6 - Additional Considerations (continued)

- US listed companies **voluntarily** impose certain restrictions on Weighted Voting Right structures:
  - Most convert to "one-share-one-vote" shares on transfer of beneficial ownership to someone not affiliated with the original holder
  - Some require holders to maintain beneficial ownership above a particular threshold (e.g. Baidu, Inc requires its founder to maintain a 5% interest)
  - Some have sunset clauses after which the dual-class share structure falls away (e.g. Groupon, Inc has a five year sunset clause)
  - Other restrictions are possible and could be considered and comments are welcome

Questions

- **Question 1:** Should the Exchange in no circumstances allow companies to use Weighted Voting Right structures?

  Respondents are asked to answer the remaining questions only if they believe there are circumstances in which companies should be allowed to use Weighted Voting Right structures.

Questions

- **Question 2:** Should the Exchange permit Weighted Voting Right structures:

  (a) for all companies, including existing listed companies; or

  (b) only for new applicants; or

  (c) only for:

  - **(i)** companies from particular industries (e.g. "information technology" companies);
  - **(ii)** "innovative" companies;
  - **(iii)** companies with other specific pre-determined characteristics (e.g. size or history); or

  (d) only in "exceptional circumstances" as permitted by current Listing Rule 8.11?[11]

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

11. GEM Rule 11.25.

Questions

- **Question 3:** If a 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 in the US, or others in addition or in substitution?
- **Question 4:** Should other Weighted Voting Right structures be permissible, and, if so, which ones and under what circumstances?
- **Question 5:** Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use Weighted Voting Right structures?

Questions

- **Question 6**: Do you have any comments or suggestions regarding the additional matters:

  (a) using GEM, a separate board, or a professional board to list companies with Weighted Voting Right structures; and

  (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a Weighted Voting Right structure or seeking a further primary or secondary listing here?

- **Question 7:** Do you have any other comments or suggestions regarding Weighted Voting Right structures?

Next Steps

- The Exchange:
  - notes there are divergent views
  - hopes to elicit responses from a broad cross-section of the market community
  - anticipates the Concept Paper may lead to one of two possible outcomes:

(a) a conclusion that no amendment to the Listing Rules to allow companies to use Weighted Voting Right structures is appropriate at this time and that current practice is supported. In this case, the Exchange would publish conclusions explaining the reasons for any such outcome

(b) support for a material change to the Listing Rules on the acceptability of Weighted Voting Right structures. In these circumstances, the Exchange would again publish conclusions. Any change to the Listing Rules would require a second stage formal consultation process including consultation on the details and the scope and language of any proposed Listing Rules changes

- The Exchange will consult the Takeovers Panel as part of the consultation exercise

Responses to the Concept Paper should be submitted by 30 November 2014

Q&A