

By email to

Response@hkex.com.hk

Dear sirs,

SUBJECT: Re: Corporate WVR CP

We appreciate the recent paper issued by the HkEx on the above topic and for the opportunity for feedback provided by your consultation process.

Robeco is a global asset manager, based in the Netherlands managing approximately USD 180bn in assets for our clients. We are an active member of the Asian Corporate Governance Association, to which we have also submitted our feedback on the issue of WVRs, and more recently on the proposed corporate WVR ("CWVR").

Robeco is also a member of the International Corporate Governance Network ("ICGN"), of whose investor members (with aggregate assets under management exceed \$34tn), more than 80 per cent responded negatively in a recent member survey about dual class shares.

Note - Any page or other references in our remarks below (unless otherwise indicated) refer to the "Consultation Paper = Corporate WVR Beneficiaries".

Major issues to be addressed

The primary justification of allowing WVR is that certain founders of some truly innovative businesses have unique relevant skills, knowledge etc. which can contribute to significant value creation for investors.

There is evidence to suggest that after an initial period of exception shareholder returns, WVR companies then under-perform one-share-one-vote ("OSOV") companies.¹ Even then, the evidence of sustained value creation remains limited to only a handful of companies, e.g. Alphabet, Facebook etc.

These proposals raise several major issues or risks to the long-term confidence of investors in the overall Hong Kong market, and we list some below. The first three are also well-known issues with non-corporate WVR, but we still wish to reiterate them.

1. The agency issue - The controlling Shareholders maintains control with disproportionately smaller share of the company's equity.
2. The fiduciary issue
3. The entrenchment issue
4. The "waterfall" effect

That Controlling Shareholders can maintain control with disproportionately smaller equity militates against the core of corporate governance principles where the cornerstone principle remains one-share, one-vote ("OSOV"). Furthermore, significant agency issues are raised, and investors have already submitted their concerns on this issue to the earlier HkEx Consultation on WVRs in 2014.

In particular, any features of safeguards such as automatic conversion (of high- voting shares to low-voting shares) and equal-treatment provisions need further scrutiny.

The fiduciary issue

Corporate entities are not natural persons and therefore cannot become directors, and therefore corporates do not owe a fiduciary duty of care to the entities nor the shareholders of the entities they control.

Therefore, WVRs could be exercised by corporates without them owing fiduciary duties to the company and to its shareholders. This is a significant risk and is also acknowledged by the HkEX itself (page 8 of the CP).

The entrenchment issue

The WVR assigned to WVR shares is not time-based but subject to a natural sunset clause (e.g. beneficiary dies or is incapacitated). Entrenchment of founders and their heirs means that sunset clauses should be watertight. We note that the Exchange provides for a 10-year limit, but we would recommend it to be reduced to five years.

The waterfall effect is when corporate WVR beneficiaries can also be Controlling Shareholders who could exercise significant/majority voting in a listing applicant with a small & indirect stake. This misalignment is exacerbated if the corporate WVR beneficiary is itself controlled through WVR of another entity. We recommend that the listing applicant is controlled ultimately by only one corporate entity.

Safeguards

Possible enhancements & safeguards for corporate WVRs should include some of all the following: -

- Mandatory sunset (time-limited)
- Event-based sunset
 - Named founders no longer directors of relevant company
 - No transfer of founder shares to another person
- Require true and reasonable sunset provisions for differential common stock voting rights (that cannot be overridden by the controlling shareholder, as often happens); and
- Consider enhanced board requirements for dual-class companies to build greater confidence that boards do not simply rubber-stamp founder managers or the controlling family.ⁱⁱ
- HKEX's Consultation Paper suggests that a Corporate Governance Committee makes recommendations to the Board, but we believe that such a committee would lack credibility.
- For the proposed Nominee of the beneficial WVR, the nominee should have an undertaking to have a fiduciary duty to all shareholders
- Reverting to a one-share one vote on related party transactions ("RPTs") and large transactions (e.g. greater than 20% of annual profits)

Mandatory corporate governance enhancements: -

- Requirements to hold annual general meetings open to all investors
- Mandatory appointment of independent directors representing at least a majority of the board
- Issuer should appoint an independent Chair or Lead Directorⁱⁱⁱ

- Eliminate any pre-bid defenses^{iv}, requiring takeover proposals to be subject to mandatory One-Share-One-Vote for all WVR issuers.
- Provisions for minority investors to appoint several of the board’s independent directors

The 2018 CFA report takes a deep look at broad safeguards, which include most of the above as well as:

- maximum voting differentials
- limitation of share classes
- specific admission and investor requirements

We recommend that the HkEx reviews all the above proposed safeguards for their applicability to Corporate WVRs.

Mandatory sunset provisions include:

- Time-based sunset provisions. We favor the use of time-based provisions for a period of not more than ten years, provided that the majority of shareholders not affiliated with the WVR beneficiary approves any further extensions.
- Event-based sunset provisions. Although arrangements provide for the conversion to a single-class structure on the occurrence of a specified event, this still allows the beneficiaries of the WVR to retain control for the remainder of their working lives.

We agree with the proposal to subject the WVR of a corporate WVR to a sunset of not more than 10 years. However, we recommend that the WVR of the corporate WVR beneficiary could only be renewed with the approval of only the independent shareholders (HkEX does not define “independent”, but we wish that the HkEx clarifies that this includes all individual and corporate shareholders with no WVR rights, that is shareholders unaffiliated with the controller.^v As Bebchuk and Kastiel explain, the reason for the controller’s resistance to unification, even though the benefits of a dual class structure has passed, is “that the controller would capture only a fraction of the efficiency gains [of unification], which would be shared by all shareholders, but would fully bear the cost of forgoing the private benefits of control associated with the dual-class structure.” And indeed, empirical evidence appears to bear this out. Thus, the problem of a controller wanting to delay unification is a valid concern.

Minimum economic interest and maximum votes per share

Point 33 on page 9 of the CP “the Exchange proposes that a corporate WVR beneficiary must have held a beneficial interest or more than 10%... for at least two financial years...”. We believe that a 10% economic interest which allows a WVR beneficiary to exercise control is far too low, and that this ratio should be at least 30% as per the following point.

Points 32-36 of the CP suggests that HkEX should require a corporate WVR beneficiary to beneficially own at least 30% of the underlying economic interest of the listed applicant’s total issued capital, both prior to listing and as long as the listco remains listed. Nevertheless, it still unlikely to address the issue of control lasting for an excessive period. This requirement does provide some benefits by improving the alignment of interest of the

WVR beneficiary with other shareholders, and we support the proposal to cap the extent of control that corporate WVR beneficiaries can exercise, and that they are entitled to benefit from shares that carry a maximum of five times the voting power of ordinary shares.

Automatic conversion to OSOV shares on share transfers

Both the Singapore and Hong Kong Exchanges and have already adopted this safeguard, and we would expect this measure to continue if Hong Kong adopts Corporate WVR.

Voting premiums increase with firm age, suggesting that private benefits increase over maturity. Most sunset provisions that dual-class firms adopt are ineffective. Evidence suggest that effective, time-consistent sunset provisions would be based on age or on inferior shareholders' periodic right to eliminate dual-class voting.¹

Size of listing applicant relative to WVR beneficiary

We agree with the HkEx proposal to ensure an existing issuer cannot introduce a WVR structure over a material part of its assets, but we would reduce the ring-fencing measure from 30% to 10% of the corporate beneficiary's market capitalization. 10% is a widely accepted metric for materiality.

Ring-fencing

We believe that the definition and benefits of a community or "ecosystem" are too subjective to be meaningfully used in the framework. Therefore, the proposal that the WVR's issuer's corporate governance committee confirm such terms of reference are also unlikely to be effective.

The HkEX CP suggests an eligibility criteria of a minimum market capitalization (of HK\$40bn) contributes to investor safeguards, which we fail to understand. The HkEX assertion that high market capitalization has "developed to a reasonable scale" and is less risky may not be valid, as market capitalization or size alone could simply reflect investor exuberance.

Much of the evidence for successful WVR structures indicate that such enterprises outperform in the earlier years of evolution and underperform when they attain a certain maturity. Furthermore, many so-called innovative companies' attributes of unique business models and/or high growth, also attract individual/retail investors.

One of the main investor safeguards of "sunset provisions" would be impossible to enforce with corporate entities, unless specific provisions are created to allow for their automatic dissolution after a fixed period. Any such sunset provisions should be shorter than the current 10-year period for individual WVRs, for example after five years (e.g. Groupon, Texas Roadhouse).

If company founders/promoters believed they needed to have increased control in order to pursue a significant, innovative transformation, current single-class firms could be given a flexible option to convert to WVRs through an extraordinary shareholder vote.

¹ Sticking around Too Long? Dynamics of the Benefits of Dual-Class Voting, H.Kim & R. Michaely, European Corporate Governance Institute (ECGI) - Finance Working Paper No. 590/2019
Swiss Finance Institute Research Paper No. 19-09

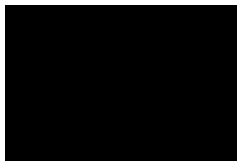
Our suggested safeguards are on the understanding that investors most desirable outcome is unlikely to be the most likely one, and therefore we re-iterate our strong preference for the continuation of the One-Share One-Vote (OSOV) principle.

Other

The U.S. Council of Institutional Investors advocated to bar non-voting shares from stock indices, followed by the MSCI consultation concluding to (a) remove the restriction on WVR stocks and (b) launch new indices adjusted for voting rights. The HKEx could (in conjunction with Hang Seng Indices) could consider launching some similar, adjusted indices which would improve (retail) investor awareness of the issues and increase investor choice.

Finally, we wish to thank the HK Exchange again for offering investors the opportunity to submit our feedback as part of the consultation process for these new proposals.

Your sincerely,



ⁱ Dual-class shares: The Good, The Bad, and the Ugly – CFA Institute, 2018

ⁱⁱ Snap and the Rise of No-Vote Common Shares, Snap and the Rise of No-Vote Common Shares 09 March 2020

ⁱⁱⁱ Harvard Law School Forum on Corporate Governance and Financial Regulation, June 2019

^{iv} The Impact of Dual Class Shares on Takeover Risk and the Market for Corporate Control, Holmen. M., and Nivorozhkin, E., Uppsala University and the University of Groningen

^v The Untenable Case for Perpetual Dual-Class Stock, Bebchuck, L. and Kastiel, K., Harvard Centre for Law, Economics & Business