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The Hong Kong Institute of Chartered Secretaries

Submission:

Consultation Paper on Corporate WVR Beneficiaries

The Hong Kong Institute of Chartered Secretaries 香港特許秘書公會
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Dear Sirs

Consultation Paper on Corporate WVR Beneficiaries

Terms and expressions used in this Submission shall have the meanings set out under the Consultation Paper unless the context requires otherwise.

About HKICS

The Hong Kong Institute of Chartered Secretaries (the Institute) is an independent professional institute representing Chartered Secretaries and Chartered Governance Professionals as governance professionals in Hong Kong and the mainland of China (the Mainland) with over 6,000 members and 3,200 students. The Institute originates from The Chartered Governance Institute, formerly known as The Institute of Chartered Secretaries and Administrators (ICSA) in the United Kingdom with nine (9) divisions and over 30,000 members and 10,000 students internationally. The Institute is also a Founder Member of Corporate Secretaries International Association Limited (CSIA), an international organisation comprising 14 national member organisations to promote good governance globally.

Background

In December 2014, our Institute made a submission to HKEX on the topic of individual WVR. We stressed then that the consensus amongst our members was that the 'one-share-one-vote' approach was the best structure to promote corporate governance and deviations therefrom, for example, where connected persons may not vote their shares, should primarily be for the purposes of enhancing minority protection. Despite this consensus, there were members who took the view that listings with WVR could be considered where these would enhance the competitiveness of Hong Kong as an international financial centre to attract innovative listings, subject to enhanced minority protections to narrow the governance gap between 'one-share-one-vote' and WVR. In this connection, as previously submitted, Hong Kong should consider introducing a statutory derivative action regime to enhance private enforcement rights which could supplement the limited resources of regulators to take enforcement actions.

Likewise, for the current proposal, we have members who support the proposal, on the basis that it will enhance the competitiveness of Hong Kong as an international financial centre. These members see that the 30 per cent investment required of corporate WVR beneficiaries equates with *de facto* control in most cases already, and an effective 68% voting right, where this 30% floor is maintained, is acceptable. There was also support because of the limited pool of corporate WVR beneficiaries given the ecosystem concept and the requirement for them to be substantial regulated persons on the Exchange/Qualified Exchanges. Other members do not support the introduction of WVR on the basis that it is not good governance, and feel that Hong Kong should not join the chorus for the "race to the bottom". These members consider that Hong Kong needs to distinguish itself as a quality market and have the view that, in the long-run, having corporate WVR does more harm to Hong Kong than good.

Our Institute remains of the view that the 'one-share-one-vote' approach is the best governance structure to adopt but, given the different views of our members, wishes to provide governance related suggestions on the proposal, in case corporate WVR are introduced by HKEX based on the market consensus, as was the situation with individual WVR.

Overview

Following publication of Chapter 8A of the Listing Rules, there have been a number of listings of innovative companies with individual WVR. This began with Xiaomi as a primary listing. Then there was Alibaba as a secondary listing (with certain grandfathered rights). Following these milestones, corporate WVR are now being proposed by HKEX and, in our view, offer even more challenges than individual WVR.

A fundamental issue is that, conceptually, it is difficult to justify WVR for corporates as against individuals. The founder, quite simply, founded the innovative business and, in all likelihood, will be committed to the long-term success of the listing applicant after listing the business. However, this does not automatically follow for corporates, with ownership and management changes being possible. Accordingly, while there is no doubt that the concept of an 'ecosystem' is important under HKEX's proposal, we see the mechanisms under the proposal to ensure that corporate WVR beneficiaries are committed to the long-term business and success of the listing applicants as being the critical elements of the proposed governance framework.

It follows that it is the requirement that the corporate WVR beneficiaries need to maintain 30 per cent equity that represents the centrepiece of the HKEX proposal in the view of our Institute. This is some three times the 10% required of individual WVR and, we consider, appropriate.

Another difficulty with the HKEX proposal is that while, superficially, the corporate WVR beneficiaries are themselves substantial regulated persons on either the Exchange or a Qualified Exchange (with a market capitalisation of at least HK\$200b) and therefore expected to be well-governed, this does not necessarily hold true from a deeper analysis. For example, with certain US Qualified Exchanges, there are a number of exemptions to the governance requirements of overseas-incorporated issuers. They may not even be required to hold annual general meetings. We submit that HKEX should identify key expected governance requirements and ensure that the corporate WVR beneficiaries listed on other Qualified Exchanges comply

with the equivalent of these requirements as part of the suitability assessment of corporate WVR beneficiaries. In addition, the market capitalisation of the corporate WVR beneficiaries should be reviewed from time-to-time (for example annually) to ensure that they remain substantial regulated persons with expected manifestations of good governance.

HKEX's Q&As

Q.1 Do you agree, in principle, that the Exchange should expand the existing WVR regime to enable corporate entities to benefit from WVR provided that they meet appropriate conditions and safeguards? Please give reasons for your views. If your agreement is conditional upon particular aspect(s) of the proposed regime being implemented, please state what those aspect(s) are.

We subscribe to 'one-share-one-vote' approach as the best form of governance given our legal and regulatory regimes and not corporate WVR which are fraught with difficulties. However, if corporate WVR are inevitably allowed by HKEX for Hong Kong to make Hong Kong competitive as an international financial centre, we would nevertheless provide our observations to HKEX to strengthen HKEX's proposal from the corporate governance perspective.

Q.2 Do you agree that a corporate WVR beneficiary must be either the Eligible Entity or a wholly owned subsidiary of the Eligible Entity? Please give reasons for your views. In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We agree and regard this to be of importance. This is because the Eligible Entities (and their wholly-owned SPVs) should be substantial regulated persons on either the Exchange/Qualified Exchanges. This approach strengthens the overall regulatory governance under HKEX's proposal. We have also identified, under this Submission, the need for equivalence with the Exchange requirements for corporate WVR beneficiaries listed on other Qualified Exchanges, along with periodic review of the corporate WVR beneficiaries' market capitalisations.

Q.3 Recognising that, with at least a 30% economic interest, the corporate WVR beneficiary would be regarded as having "de facto control" of the relevant listing applicant even without WVR and would be considered a Controlling Shareholder under both the Listing Rules and the Takeovers Code, the Exchange has proposed a minimum shareholding requirement for a corporate WVR beneficiary to own at least 30% of the economic interest in the listing applicant. Do you agree with the proposed requirement for a corporate WVR beneficiary to: own at least 30% of the economic interest in the listing applicant; be the single largest shareholder at listing; and that its WVR should lapse if it fails to maintain at least a 30% economic interest on an ongoing basis? Please give reasons for your views.

Q.4 If your answer to Question 3 is "no", do you propose a different economic interest in order for the applicant to benefit from WVR and, if so, what this should be? Do you believe that any other conditions and requirements should be imposed if a lower economic interest threshold is allowed? If so please state these conditions/requirements.

Please give reasons for your views. In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We regard this as the centrepiece of the proposals and agree that 30% equates with *de facto* control and the Controlling Shareholder test under the Listing Rules/Takeovers Code. We further agree that the failure to meet the requisite threshold should result in the loss of the corporate WVR.

Q.5 Do you agree with the proposed exception from the Rules to permit an issuance of shares on a non-pre-emptive basis to a corporate WVR beneficiary without shareholders' approval if the conditions set out in paragraph 144 of the consultation paper are satisfied?

Please give reasons for your views. If your answer to Question 5 is "no", and you agree with the requirement for the corporate WVR beneficiary to hold at least 30% of economic interest in the issuer on an ongoing basis, what alternative measures would you propose to enable such minimum economic interest to be maintained on an ongoing basis?

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We submit that these matters could be subject to confirmation of the Corporate Governance Committee/appropriate professional advice to enhance protections to minority shareholders.

Q.6 Do you agree with the proposed requirement that a corporate WVR beneficiary must have held an economic interest of at least 10% in, and have been materially involved in the management or the business of, the listing applicant for a period of at least two financial years prior the date of its application for listing?

Please give reasons for your views. If your answer to Question 6 is "no", do you agree that a historical holding requirement should be imposed? If so what alternative threshold or holding period would you propose?

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

It makes sense that pre-IPO there should be at least 10% shareholding and material involvement in the management or the business of the listing applicant for a period of at least two financial years to show long-term commitment in the listing applicant.

Q.7 Do you agree that the maximum ratio of weighted votes permitted for shares of a corporate WVR beneficiary should be lower than the maximum ratio permitted for individual WVR beneficiaries? Do you agree that this ratio should be set at no more than five times the voting power of ordinary shares? If not, what is the maximum ratio that you would propose?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We agree. The founder's position is unique, and the 5x to 10x differential is justified.

Q.8 In summary, the Exchange recognises that the synergistic benefits of the ecosystem and the strategy and vision of the leader in developing the ecosystem may be difficult for a listing applicant to replicate on its own or with other business partners; and that this provides a basis for the listing applicant to determine that it is in its interest to issue WVR shares to the lead company within the ecosystem in order to reinforce its own role within the ecosystem. Accordingly, the Exchange has proposed that a corporate WVR beneficiary should be required to demonstrate its contribution through the inclusion of the listing applicant in its ecosystem in order to benefit from WVR. Do you agree with the Exchange's proposal in relation to the ecosystem requirement?

Q.9 Do you agree with the required characteristics of the ecosystem as outlined in paragraph 156 above? Please elaborate if you wish to propose an alternative or additional criteria.

Q.10 Are there other circumstances relevant to innovative companies that, in your view, could either (a) justify granting WVR to a corporate WVR beneficiary; or (b) be required as a pre-requisite to being granted WVR?

Q.11 Do you agree that the corporate WVR beneficiary can be a traditional economy company provided that it develops a similar ecosystem which can satisfy the eligibility criteria?

Q.12 If your answer to Question 8 is "yes", do you agree that the corporate WVR beneficiary should be required to provide a contribution to the WVR issuer (e.g. by facilitating the applicant's participation in the ecosystem and including the applicant in its vision and planning for the ecosystem) on an ongoing basis as described in paragraph 160?

Q.13 Are there alternative or additional conditions or requirements that you would propose for the corporate WVR beneficiary or the WVR issuer on an ongoing basis?

Q.14 If your answer to Question 12 is "yes", do you agree that a WVR issuer's corporate governance committee should (after making due enquiries) confirm, on a six month and annual basis, that there has been no termination or material disruption, etc., to the corporate WVR beneficiary's contribution to the listing applicant as described in paragraph 161? Alternatively, would you prefer there to be a different mechanism to check that this requirement is being met? If so, please state what this should be.

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

It is important that the corporate WVR beneficiaries and listing applicants collectively demonstrate that the matters required under Q.8 at the time of the listing applications and periodically, say annually thereafter, with supporting opinions. Also, under paragraph 160 of the Consultation Paper, there should be a discretion retained for disruption and/or suspension for a period of less than 12 months, as 12 months is a long time for an innovative listed company. We submit that under paragraph 161 of the Consultation Paper, the requisite composition of the Corporate Governance Committee should include persons with backgrounds to assess the ecosystem and compliance with the new rules, and requisite governance background. There should be guidance on the composition, procedures and other details provided by the Exchange, to reduce the risk of this being a box ticking mechanism.

Q.15 Balancing the need to ring-fence corporate WVR beneficiary on a fair, rational and justifiable basis to avoid a proliferation of WVR structures, and the risk that a high market capitalisation requirement may be seen as creating an uneven playing field, the Exchange has proposed that a prospective corporate WVR beneficiary must have an expected market capitalisation of at least HK\$200 billion at the time of the WVR issuer's listing. Do you agree with the proposed minimum market capitalisation requirement of HK\$200 billion for a prospective corporate WVR beneficiary? Please state the reasons for your views.

Q.16 Do you consider that any exceptions to the market capitalisation requirement should be provided? If your answer to this question is "yes", please explain the reason(s) for your view and state under what circumstances, and the factors that you consider to be relevant.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We have no issue with the market capitalisation set at a minimum of HK\$200 billion, and note that there were 297 companies on the Exchange and Qualifying Exchanges as at December 2019. Also, under paragraph 168(b) of the Consultation Paper, do you mean significant equivalence to the Hong Kong regime?

Q.17 Do you agree with the proposed requirement that to be suitable to benefit from WVR, a corporate WVR beneficiary must be either: (a) an Innovative Company or (b) have business experience in one or more emerging and innovative sectors as well as a track record of investments in, and contributions to, innovative companies?

Q.18 Do you agree with the proposed requirement that to benefit from WVR, a corporate beneficiary must have and maintain a primary listing on the Exchange or a Qualifying Exchange?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

On Q.17, we agree, as these are indicia of the importance of the corporate WVR beneficiaries' ecosystems. As explained in this Submission the matters referred to under Q.18 are important from the governance perspective.

Q.19 Do you agree with the requirement that a listing applicant must not represent more than 30% of the corporate WVR beneficiary in terms of market capitalisation at the time of its listing? If not, do you prefer an alternative threshold?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We have no issue as that leaves at least HK\$140B for the other business interests. What we are concerned with is whether the other businesses would somehow conflict or potentially conflict with the listed issuer's business. We assume these issues would be part of the normal vetting under the IPO process. It would be useful to provide guidance to potential sponsors, if necessary. The worst case is that the corporate WVR beneficiaries cannibalise their own innovations which could be valuation driven.

Q.20 Do you agree with the proposed requirement that at least one director of the listing applicant must be a Corporate Representative? Are there any alternative or additional measures that you would propose to increase a corporate WVR beneficiary's responsibility and accountability for how it exercises its control?

Please give reasons for your views.

Q.21 Do you agree that the WVR attached to a corporate WVR beneficiary's shares must lapse permanently if:

- (a) the beneficiary no longer has a Corporate Representative on the listed issuer's board of directors for a continuous period of 30 days;
- (b) the Corporate Representative is disqualified as a director or found unsuitable by the Exchange as a result of an action or decision taken in his or her capacity as director of the listed issuer save where the corporate WVR beneficiary is able to demonstrate to the Exchange's satisfaction that the action or decision was taken outside of the authority granted by the corporate WVR beneficiary to the Corporate Representative; or
- (c) the corporate WVR beneficiary has been convicted of an offence involving a finding that the beneficiary acted fraudulently or dishonestly?

If not do you suggest any alternative criteria?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper

We have no issue with there being at least one director of the listing applicant being the Corporate Representative and the consequences of the defined events. But what is the position relating to the corporate WVR beneficiaries? If they commit any market misconducts or violations of the provisions of the SFO, or equivalent relevant to any Qualified Exchanges should there not be some related consequences on the corporate WVR held by the corporate WVR beneficiaries? These issues need to be considered.

Q.22 Do you agree that the Exchange should impose a time-defined sunset on the WVR of a corporate WVR beneficiary?

Please give reasons for your views.

Q.23 If your answer is "yes", do you agree with the proposed maximum 10 year length of the initial "sunset period"? If not, what length of period would you prefer?

Please give reasons for your views.

Q.24 Do you agree that the WVR of a corporate WVR beneficiary could be renewed at the end of the sunset period with the approval of independent shareholders? If so, do you agree with the maximum five year length of the renewal period or would you prefer an alternative renewal period length?

Please give reasons for your views.

Q.25 Do you agree that there should be no limit on the number of times that the WVR of a corporate WVR beneficiary could be renewed? If not, what is the limit that you would propose?

Q.26 Should the Exchange impose any other requirements on a corporate WVR beneficiary as of a condition of renewing its WVR? If so, please provide details of the suggested requirement.

Please give reasons for your views.

In your response, you may propose additional or alternative measure to the ones discussed in this paper.

We have no issue with these mechanisms and note that in the market place there are calls for shorter timeframe for the sunset at 5 to 7 years. We do not have any issue with the sunset at 7 years as a balance between the length of the corporate WVR and the commitment shown by corporate WVR beneficiaries. We also assume that there may be other events that terminate the corporate WVR including, liquidation, insolvent reorganisation, and the presence of the ecosystem being no longer a substantially valid proposition. At renewal in addition to disinterested shareholders' vote, it could be explored if the market capitalisation of the corporate WVR beneficiaries and/or listed companies with corporate WVR should be considered in addition to any annual review of these issues.

Q.27 Do you agree that the Exchange should not restrict an issuer from granting WVR to both corporate and individual beneficiaries provided that each meets the requisite suitability requirement?

Please give reasons for your views.

Q.28 Are there any additional measures that you would propose for the WVR beneficiaries or the WVR issuer to safeguard the interests of the WVR issuer (e.g. prevent a deadlock) if there were both corporate and individual beneficiaries?

Q.29 Do you agree that where an issuer has both a corporate WVR beneficiary and individual WVR beneficiaries, the time-defined sunset should only apply to the corporate WVR beneficiary?

Please give reasons for your views.

Q.30 Do you agree that, in the event that the WVR of the corporate WVR beneficiary falls away as a result of its time-defined sunset, the individual beneficiary should be required to convert part of his or her WVR shares into ordinary shares such that the individual beneficiary will control the same proportion of voting power in the issuer both before and after the corporate WVR beneficiary's WVR fall away?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We do not have any significant issue with any of these matters, and in case of dispute between the individual and corporate WVR beneficiaries, this should be dealt with according to the law. The other ways to protect minority shareholders could include the right of minority shareholders to appoint an independent director and/or veto rights over certain defined issues. However, these are also not consistent with the 'one-share-one-vote' principle.

Q.31 Do you agree that the Listing Rules need not mandate that, if an individual beneficiary's WVR falls away before a corporate WVR beneficiary's WVR, the corporate WVR beneficiary should convert part of its WVR shares into ordinary shares such that the corporate WVR beneficiary will control the same proportion of voting power in the issuer both before and after the individual beneficiary's WVR fall away?

Please give reasons for your views.

In your response, you may propose additional or alternative measures to the ones discussed in this paper.

We have no issue in this regard.

Should you have any questions, please feel free to contact

[REDACTED]
[REDACTED]
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Yours sincerely

For and on behalf of

The Hong Kong Institute of Chartered Secretaries

[REDACTED]