HERMES

HERMES EQUITY OWNERSHIP SERVICES LIMITED

[redacted]

Response to HKEx Consultation on Proposed Changes to the Listing Rules

Introduction

Hermes is one of the largest pension fund managers in the City of London and is wholly owned by the BT Pension Scheme. We also respond to consultations such as this one on behalf of many other clients, including Ireland's National Pension Reserve Fund, Denmark's PKA, Pensioenfonds PNO Media of the Netherlands and Canada's Public Sector Pension Investment Board (only those clients which have expressly given their support to this response are listed here). We have some £35 billion assets under management and over £45 billion assets under advice.*

Hermes takes a close interest in matters of company law and regulation because they set the context for the exercise of our clients' rights as part owners of the companies in which they invest. We seek to safeguard our clients' current rights and also to enhance the transparency and accountability of companies and their directors to their long-term owners.

By enhancing accountability, we hope to improve efficiency by addressing what economists call the agency problem. It is our fundamental belief that companies with concerned and involved shareholders are more likely to achieve superior long-term returns than those without. By helping make company directors accountable to company owners for the decisions they make and the actions that they take, we believe that over time we will encourage better decision-making and greater value-creation. We believe that this will benefit our clients, which need long-term real growth to meet their obligations to pension beneficiaries, and it will also make companies and economies as a whole more efficient.

In pursuit of these aims Hermes supports a flexible regime which will:

- encourage company accountability;
- encourage responsible ownership by shareholders and fiduciaries;
- ensure independence of those who audit and monitor company performance; and
- ensure the measures used in reporting performance are relevant for owners.

This consultation covers a wide range of issues. We would like to emphasise our view on two of the questions raised in the Consultation Paper. First, as the representative of long-term investors, Hermes strongly supports the principle of pre-emption. We believe that it is a proprietary right through which the current shareholders of a company can retain their ownership without finding their interest diluted by the introduction of other investors and finance.

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Second, we would strongly suggest that regulators in Hong Kong consider making voting by poll mandatory. The process of voting by show of hands effectively disenfranchises those shareholders who do not attend the meeting. As they will often represent the majority of shares, this reduces the accountability of companies to their owners and discourages investors from the intelligent exercise of their votes.

In addition, we would highlight two major concerns. First, we feel that there is a significant justification for the requirement that each listed company has a "qualified accountant" in its senior management team. Given the growing number of PRC issuers listed on the HKSE, we have concerns that the proposed removal of this requirement could lead to a decline in financial reporting standards and increase the risks that investors face.

Second, a sufficient size of public float is an important element of minority investor protection. Hermes believes that ensuring an open market and sufficient liquidity for securities, thus providing confidence to investors that the management of companies can be held to account for their decisions, is necessary to maintain the reputation of the Hong Kong market an international financial centre.

** Figures as at December 31st 2007*

Combined Consultation Paper on Proposed Changes to the Listing Rules

Issue 2: Information gathering powers

Question 2.1: Do you agree that a new Rule should be introduced to grant to the Exchange express general powers to gather information?

Yes, we think that the proposal will reinforce the general powers for the Exchange to carry out effectively its regulatory functions and to gather information from listed issuers, especially when the issuers are subject to disciplinary hearings.

Issue 3: Qualified accountants

Question 3.1: Do you agree that the requirement in the Main Board Rules for a qualified accountant should be removed? Please provide reasons for your views.

No, we oppose this proposal. We think the current requirement for a listed issuer to employ a qualified accountant at the senior management level, who is qualified as a member of the HKICPA or a similar body of accountants recognised by the HKICP, helps to maintain effective internal controls which ensure proper financial reporting. As such, the requirement strengthens the corporate governance of issuers. Especially given the growing number of PRC issuers listed on the HKSE, we think that the proposed removal of the requirement, which means that issuers would be allowed to decide who their accountant will be and whether they need to have any qualification, will almost certainly lead to a decline in financial reporting standards and increase the risks that investors face.

Question 3.2: Do you agree that the requirement in the GEM Rules for a qualified accountant should be removed? Please provide reasons for your views.

No, we do not consider that a loosening of this requirement for GEM companies is appropriate.

Issue 4: Review of sponsor's independence

Question 4.1: Do you agree that the Rules regarding sponsor's independence should be amended such that a sponsor is required to demonstrate independence at any time from the earlier of the date when the sponsor agrees its terms of engagement with the new applicant and when the sponsor commences work as a sponsor to the new applicant up to the listing date or the end of stabilisation period, whichever is the later?

Yes, we think that requiring sponsor independence through the entire listing process, instead of only a certain period of the process, is sensible.

Issue 5: Public float

***Background: currently the Main Board Rules require a minimum public float of 25% of the issuer's total issued share capital. This percentage can be lowered at the discretion of the Exchange if the issuer's market capitalisation exceeds a certain threshold. Rule 8.08(1)(d) states that the Exchange may, at its discretion, accept a lower percentage of public float between 15% and 25% in the case of issuers with an expected market capitalisation at the time of listing. In this Consultation Paper, a minimum public float of 10% of the total issued share capital (or a public float with a market value of at least HK$6 billions) is being proposed for companies with market capitalisation of over HK$40 billion.**

Hermes opposes lowering the required threshold of a minimum public float. To provide an open, fair and orderly market for the investing public, it is essential to maintain a certain level of public float with a view to ensuring the availability of a minimum level of shares for trading and minimising the possibility of market manipulation. Therefore, we think that a sufficient size of public float is an important element of minority investor protection. Hermes believes that ensuring an open market and sufficient liquidity for securities, thus providing confidence to investors that the management of companies can be held to account for their decisions, is necessary to maintain the reputation of the Hong Kong market an international financial centre.

In addition, we do not support in principle giving large PRC issuers a waiver regarding strict compliance with the 15% rule and allowing them to count strategic investors in their public float. As these investors typically have lock-up periods (e.g. from six months to three years), seats on the board, and other strategic business agreements, we think that their shareholdings of should not be considered as free or public float. Therefore, we support the proposal to tighten the definition of "public", so as not to include investors holding 5% or more of the voting power in the company and any shares subject to a lock-up of more than six months, as a move in the right direction.

Issue 7: Review of the Exchange's approach to pre-vetting public documents of listed issuers

Question 7.1: Do you agree that the Exchange should no longer review all announcements made by listed issuers? Please provide reasons for your views.

Yes, Hermes supports this change in principle. We think that shifting the Exchange's regulatory focus from pre-vetting towards post-vetting, monitoring and enforcement is a sensible proposed change. In the meantime, however, the Exchange should provide appropriate and clear guidance for listed companies to maintain the quality of information released to the market especially during the transition period. Moreover, we would hope that the change will eventually lead to improvements in corporate governance practices among local companies.

Issue 11: General mandates

Question 11.1: Should the Exchange retain the current Rules on the size of issues of securities under the general mandate without amendment?

No, we strongly suggest that the current Rules relating to general mandates should be amended. Hermes strongly supports the principle of pre-emption. We believe that it is a proprietary right through which the current shareholders of a company can retain their ownership without finding their interest diluted by the introduction of other investors and finance.

Question 11.2: Should the Exchange amend the current Rules to restrict the size of the general mandate that can be used to issue securities for cash or (subject to your response to Question 11.4) to satisfy an exercise of convertible securities?

Question 11.4: Should the Exchange amend the current Rules such that: (a) the application of the current prohibition against the placing of securities pursuant to a general mandate at a discount of 20% or more to the "benchmarked price" would apply only to placings of shares for cash?

We think that, under current Rules, an issuance without pre-emptive rights up to the 20% limit of the issued share capital would have a highly dilutive impact on our clients' interests. Also, we think that a possible level of up to 20% discount to the benchmarked price at issuance is too high. We are concerned that such proposals do not offer adequate protection to existing shareholders.

We consider that the UK guidelines on Pre-Emption Rights, which set the maximum amount of share capital that may be issued non-pre-emptively for cash at no more than 5% of the total issued share capital in any one year at no more than 5% discount, are reasonable. As such, we would prefer similar guidance for Hong Kong companies.

Issue 12: Voting at general meetings

Question 12.1: Should the Exchange amend the Rules to require voting on all resolutions at general meetings to be by poll?

Yes, we would strongly suggest that regulators in Hong Kong consider making voting by poll mandatory. The process of voting by show of hands effectively disenfranchises those shareholders who do not attend the meeting. AS they will often represent the majority of shares, this reduces the accountability of companies to their owners and discourages investors from the intelligent exercise of their votes. Hermes believes that voting by poll is critical to protect international shareholders' rights and ensure their continued participation in the voting process. We have noticed a significant improvement with regard to the voting process in recent years as a number of companies have moved to conduct voting by poll and publish detailed results afterwards. However, it seems that there are still companies where voting is by show of hands. In such cases we receive no information on whether our votes have been counted at all, or correctly.

As rightly noted in the Consultation Paper, voting by poll is not mandatory in certain jurisdictions, including the UK. However, we believe that the UK market is different in some key respects from Hong Kong. The institutional investor community in this market is more established, more engaged in corporate

governance issues, and enjoys a higher quality dialogue with listed issuers on governance issues. Hence, there is arguably a higher degree of communication and information sharing between listed companies and investors than in Hong Kong.

Notice of general meetings

Question 12.4: Should the Exchange amend the Rules to provide for a minimum notice period of 28 clear calendar days for convening all general meetings? If so, should the provision be set out in the Rules (as a mandatory requirement) or in the Code on Corporate Governance Practices as a Code Provision (and therefore subject to the "comply or explain" principle)?

***Background**: currently, in the case of listed issuers other than H-share issuers, the Rules currently require 14 days notice for the passing of an ordinary resolution and 21 days notice for the passing of a special resolution. 21 days notice is also required for convening an annual general meeting. In the case of H-share issuers, 45 days notice of shareholder meetings is required under the "Mandatory Provisions for Companies Listing Overseas" for all resolutions.**

Yes, Hermes strongly supports the proposed amendments. In common with other foreign investors, our clients hold shares through a number of intermediaries, which slows the flow of information from the company to its shareholders. Under the current Rules, with the publication of AGM notices and circulars 21 days before the meeting date, we are left with little time for the exercise of judgement, which may require discussion of concerns with companies. Without the time to carefully consider voting item and exercise informed judgement, the aim of accountability can not be achieved.

Issue 13: Disclosure of information about and by directors

Question 13.1: Do you agree that the information equivalent to that set out in draft new Main Board Rule 13.51B should be expressly required to be disclosed in the Rules by issuers up to and including the date of resignation of the director or supervisor, rather than only upon that person's appointment or re-designation?

***Background**: currently, the Rules (Main Board Rule 13.51(2) and GEM Rule 17.50(2)) require that when a new director or supervisor is appointed or on the resignation or re-designation of a director or supervisor the relevant issuer must make arrangements to ensure that an announcement of the appointment, resignation or re-designation of the director or supervisor is published. The Rules require the announcement of appointment or re-designation of a director or supervisor (Appointment Announcement) to include certain information, for example:**

(a) Positions held with the issuer and other members of the issuer's group;
(b) Previous experience including other directorships held in listed public companies in the last three years and other major appointments and qualifications;
(c) Full particulars of any public sanctions made against the director or supervisor by statutory or regulatory authorities;
(d) Full particulars of any unsatisfied judgments or court orders of continuing effect against the director or supervisor;

(e) Where the director or supervisor is currently subject to (i) any investigation, hearing or proceeding brought or instituted by any securities regulatory authority, including the Hong Kong Takeovers Panel or any other securities regulatory commission or panel, or (ii) any judicial proceeding in which violation of any securities law, rule or regulation is or was alleged, full particulars of such investigation, hearing or proceeding; and
(f) Where the director or supervisor is the defendant in any current criminal proceeding involving an offence which may be material to an evaluation of his character or integrity to be a director or supervisor of the issuer, full particulars of such proceeding.

Yes, we think the proposed changes are sensible. It should be required to disclose the information described in Main Board Rule 13.51(2) and GEM Rule 17.50(2) continuously up to and including the date of resignation of the director or supervisor, rather than only upon that person's appointment or re-designation. We agree that such a change would facilitate the information provided to investors and the market.

Issue 18: Review of Model Code for Securities Transactions by Directors of Listed Issuers

Question 18.4: Do you agree that the current "black out" periods should be extended to commence from the listed issuer's year/period end date and end on the date the listed issuer publishes the relevant results announcement?

***Background: the Model Code currently provides that a director of a listed issuer is prohibited from dealing in securities of the issuer for a period of one month immediately preceding the earlier of: (a) the date of the board meeting for the approval of the issuer's annual, half-year or quarterly results; and (b) the deadline for the issuer to publish its annual, half-year or quarterly results, and ending on the date of the results announcement. The periods when dealing is prohibited are generally referred to as the "black out" periods.**

Yes, we agree that current "black out" periods should be extended. As a listed issuer has four months from the year-end and three months from the period end in which to publish annual results and half-year results respectively, the current "black out" period of one month may fail to ensure that company insiders do not abuse the market whilst in possession of relevant information.

The Proposal will prohibit directors from dealing in their listed issuer's securities during the period between the listed issuer's year/period end date and the date the listed issuer releases the relevant results announcement. Given the tendency of Hong Kong companies is to report on the deadline, we think that this Proposal would encourage companies to release their results much more quickly, which we hope would lead to improvements in disclosure and corporate governance practices among listed companies in Hong Kong.