BLACKROCK

30 November 2014

Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Submitted via email to: response@hkex.com.hk

RE: Concept Paper on Weighted Voting Rights

Dear Sirs,

BlackRock Inc. (BlackRock) is pleased to have the opportunity to respond to the Hong Kong Exchanges and Clearing Limited's concept paper titled "Weighted Voting Rights".

BlackRock is a premier provider of asset management, risk management, and advisory services to institutional, intermediary, and individual clients worldwide. As of 30 September 2014, the assets BlackRock manages on behalf of its clients totalled $4.52 trillion across equity, fixed income, cash management, alternative investment and multi-investment and advisory strategies including the iShares® exchange traded funds.

BlackRock serves clients in North and South America, Europe, Asia, Australia, Africa, and the Middle East. Headquartered in New York, the firm maintains offices in over 30 countries around the world.

BlackRock represents the interests of its clients by acting in every case as their agent. It is from this perspective that we engage on all matters of public policy. BlackRock supports policy changes and regulatory reform globally where it increases transparency, protects investors, facilitates responsible growth of capital markets and, based on thorough cost-benefit analysis, preserves consumer choice.

Response to Question 1

Should the Exchange in no circumstances allow companies to use WVR structures?

In BlackRock's view, under no circumstances should the Exchange allow companies to use weighted voting right (WVR) structures. Our rational is discussed below.

As outlined in the Concept Paper, shareholders provide capital in exchange for the entitlement to the future cash flows of a company. This entitlement should be proportionate to the amount of capital they invest. As a safeguard to the entitlement, in light of the separation of ownership and management in a listed company, shareholders are granted with voting rights to select "who manages the company for the purpose of producing future capital gains and cash flows (principally through the election or removal of directors)". Therefore, in order to serve the intended purpose, voting rights ought to be proportionate to the economic interests in the company (and thus risk exposure) of a shareholder.

As a broadly diversified, global investor, BlackRock looks to board directors to act independently and objectively to protect the interests of all shareholders. This is even more important in a market such as Hong Kong, where the rights of shareholders to remove directors are limited given the dominance of large block shareholders, such as families and state-owned enterprises. Hong Kong Listing Rules do, however, provide protection for minority shareholders in respect of connected party transactions. These protections are in place to ensure that connected transactions are in the economic interests of all shareholders.

While the provisions relating to shareholder approval of connected party transactions in Hong Kong provide some protection for shareholders, there remain a number of actions that boards of controlled entities can take in areas of material significance such as a change in strategy, making acquisitions or divestments, and balance sheet management where minority shareholders have little say. We acknowledge the ranking that Hong Kong achieved in the World Bank and International Finance Corporation's "Doing Business 2014". However, the current provisions do not protect minority shareholders against poor practices in relation to the matters on which shareholders do not get a vote, such as implementation of an ill-conceived strategy or board remuneration. The problem is further compounded by the potential influence of the block shareholder over the nomination process. This raises the question of whether the directors whom the company determines to be independent are, and are seen to be, independent from the perspective of the unaffiliated shareholders. Otherwise, there may be the perception that the directors are not acting in the interests of all shareholders.

These are significant issues for shareholders who are not affiliated with the controlling shareholder. We are concerned that the introduction of WVRs would add additional complexity to the market and would further increase the risks for shareholders not associated with the controlling shareholder and potentially comprising a majority of shareholders.

Some companies with WVRs use the structure to entrench management, commonly when the founders are still in leadership roles. Management insulated from certain shareholders by WVRs can be value adding or destroying. Some argue that the WVR structure allows management to focus on the long term, make investments and take on strategic projects that might negatively impact a company's performance in the short-term but would be value enhancing over the long-term. In other cases, such insulation can lead to value destruction because it enables or even incentivizes management to engage in activities that benefit themselves at the expense of public shareholders, who often own the majority of shares.

As with companies with a controlling shareholder, the director nomination process is often significantly influenced by entrenched management, again bringing into question the actual independence of directors, even when classified as such by the company. We do not believe that incorporating provisions in a company's articles to require a specific percentage of independent directors would necessarily protect the majority public shareholders. In any case, public shareholders have limited power to change the board if things go wrong.

We do not believe the outlined provisions relating to the conversion of WVR shares to one share one vote (OSOV) provide any protection for shareholders who are not associated with entrenched management (who may represent the majority). For example, the provision relating to JD.com effectively entrenches the founder as the sole trigger for converting shares to OSOV in the event the founder no longer holds any shares.

While in the US 7.3% and 5% of companies in the Russell 3000 and S&P 500 respectively[1] adopt a WVR structure, investors in these companies are, in extremis, able to take class actions on a contingent fee basis if treated unfairly by the shareholder(s) entrenched by the WVR structure. As an example, when Google announced its plan to create a new class of ordinary shares with no voting rights, which would allow its founders to cash out while maintaining their voting rights, a group of shareholders sued the company and eventually achieved concessions by the founders to restrict their ability to sell their non-voting shares.

Such remedies are not currently available in Hong Kong and we would not advocate for introducing them given how time consuming and costly legal processes can be. We certainly do not see the introduction of a class action system in Hong Kong as a mechanism to support the WVR structure. For majority shareholders to have to resort to the court system to ensure equitable and fair treatment by minority shareholder(s) does not make sense. Equal voting rights are a protection that pre-empt abuses. Legal remedies provide a way of compensation only after abusive activities have caused harm. Therefore, the level of protection given by legal remedies cannot match what is embedded in equal voting rights.

[1] ISS Governance M&A Edge Note February 13, 2012

It should also be noted that on November 13, 2014 at the annual general meeting of The News Corporation Limited a proposal to abolish the firm's dual-class shares, which gives the founding chairman, Rupert Murdoch 39% of the voting stock with a 14% ownership stake was narrowly defeated. This high profile meeting demonstrates that even US investors do indeed have concerns regarding WVRs and actions taken by entrenched founders.

As put forward in the concept paper, research and statistics on WVR structures may well be a factor in the decision of some Mainland Chinese companies to list in markets other than Hong Kong, particularly the US. We have looked into this and found little evidence that Chinese companies choose to list in the US market simply because it allows WVR structures.

Chinese companies listed on US exchanges are often classified as a Foreign Private Issuer (FPI). FPI status offers the issuer exemption from a number of requirements relating to corporate governance structures and disclosures that apply to issuers under the US securities laws, as well as flexibility in relation to other requirements. These benefits include the following:

- FPIs are not required to make quarterly filings of Form 10-Q (the "quarterly report") and Form 8-K (the "current report" that companies must file with the US Securities and Exchange Commission to announce major events that shareholders should know about).[2]
- FPIs have the flexibility to prepare accounts under their home country GAAP, US GAAP or IFRS. By contrast, domestic US issuers must prepare financial statements under US GAAP.
- FPIs listed on the NYSE or NASDAQ (which is the case for Chinese companies listed recently in the US) are generally allowed to follow home-country practice in lieu of complying with corporate governance standards imposed by US exchange rules on listed issuers. Most Chinese companies listed in the US use the Variable Interest Entity (VIE) structure. VIEs incorporate a structure involving a holding company that is usually based in a tax haven, such as the Cayman Islands. The tax haven countries used generally have lax corporate governance standards.

Of the 30 Chinese companies identified in the concept paper as being listed in the US with WVRs, BlackRock's analysis showed that all are incorporated in the Cayman Islands. As such, the corporate governance standards of the Cayman Islands apply. The corporate governance standards required of trading companies incorporated in the Cayman Islands are significantly lower than those required of companies incorporated and listed in either Hong Kong or the US.

For example, the following corporate governance standards apply to exempt trading companies incorporated in the Cayman Islands:

- No requirement to have a majority of independent directors;
- No requirement to have an audit committee
- No requirement to have a compensation committee
- No requirement to hold annual general meetings
- No requirements to vote on amendments to the terms of equity compensation

In summary, BlackRock believes that OSOV is an important shareholder protection that needs to be maintained in the Hong Kong Stock Exchange's listing requirements. We do not support the introduction of any form of WVRs as these would further disadvantage minority shareholders in Hong Kong-listed companies. Our analysis suggests that those Chinese companies choosing to list in the US have done so for a variety of reasons, most notably lighter touch corporate governance and reporting requirements afforded to them as FPIs, rather than because WVRs are possible. Introducing WVRs would, in our view, make Hong Kong a less attractive market for minority and foreign investors when taken into consideration with the other unique characteristics of the market. We do not believe introducing WVRs would benefit the Hong Kong Stock Exchange; indeed, we believe it would be to its detriment.

We are not answering the remaining questions because we do not believe there are circumstances in which companies should be allowed to use WVR structures.

[2] http://www.sec.gov/answers/form8k.htm

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Concept Paper and will continue to contribute to the thinking of the Hong Kong Exchanges and Clearing Limited on any specific issues.

We would welcome any further discussion on any of the points that we have raised.

Yours faithfully,

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