RESPONSE TO HKEX CONCEPT PAPER ON WEIGHTED VOTING RIGHTS

This is a joint response by the Hong Kong corporate finance departments of the international investment banking and securities firms listed below and the Asia Securities Industry and Financial Markets Association (ASIFMA) (sell-side). It is made in response to the specific questions raised by The Stock Exchange of Hong Kong Limited in its Concept Paper and represents the views of each bank's or firm's corporate finance department, advising issuer clients on equity capital markets and/or corporate finance transactions, and their contribution to this Concept Paper.

Citigroup Global Markets Asia Limited

Credit Suisse (Hong Kong) Limited

Deutsche Bank AG, Hong Kong Branch

HSBC Corporate Finance (Hong Kong) Limited

Morgan Stanley Asia Limited

Nomura International (Hong Kong) Limited

UBS Securities Hong Kong Limited

30 November 2014

Introduction

This is a joint response by the Hong Kong corporate finance departments of the international investment banking and securities firms listed on the cover and the Asia Securities Industry and Financial Markets Association (ASIFMA) (sell-side). It is made in response to the specific questions raised by The Stock Exchange of Hong Kong Limited (the ***Exchange***) in its Concept Paper and represents the views of each bank's or firm's corporate finance department, advising issuer clients on equity capital markets and/or corporate finance transactions, and their contribution to this concept paper.

In addition to this exercise, we believe that it is also necessary for a thorough examination of the matters addressed in this paper to be undertaken in the context of the Takeovers Code and from the standpoint of the investment community in order to settle upon a course of action that is in the overall best interests of Hong Kong.

Freshfields Bruckhaus Deringer have assisted us in preparing and coordinating this response, and if you have any queries on it, you should contact their Teresa Ko and David Cotton in the first instance.

As an initial comment, we would like to commend the Exchange and the Securities and Futures Commission (the ***SFC***) for bringing this issue to a public debate as we believe that it is important for the market to have clarity on this issue.

We are in support of the Exchange permitting companies to list with weighted voting rights (***WVRs***), and believe that with the suggested conditions and limitations we have outlined below, this would not result in a drop in the high standards of investor protection that apply in Hong Kong. Our support for listing companies with WVRs is based on the following key themes:

- In order for Hong Kong to defend and strengthen its position as a global financial centre, it needs to be competitive with other global financial centres. The current effective prohibition on WVRs places Hong Kong at a competitive disadvantage and as a result harms Hong Kong's global position.

- The existing Listing Rules provide investors with a very high level of protection against abuse of position by major shareholders and management and the Exchange and SFC have deep experience in applying and enforcing these rules.

- Hong Kong's unique Listing Committee approval process provides investors with the protection of a highly experienced and expert group of individuals that new applicants must satisfy in order to be listed. The dual filing regime provides a further level of protection by ensuring that the SFC is also directly involved in the vetting of IPO applications.

- As demonstrated by a number of recent cases, both the Exchange and the SFC have a strong track record of enforcement against issuers and their management and advisers, and the SFC has successfully won compensation for investors. Hong Kong does not require a class action regime as a prerequisite to allowing WVRs in appropriate circumstances.

- Permitting WVRs is an evolutionary step consistent with the Exchange's long-term broadening of the types of issuers that can list in Hong Kong (e.g. PRC companies, mining companies, companies without a profitable track record, companies using a variable interest

entity structure and overseas companies), each of which has presented new risks for investors which have been addressed by new Listing Rules, enhanced disclosure and the Exchange's suitability override.

- The current effective prohibition on WVRs is denying many investors in Hong Kong free choice of investments, while at the same time forcing other Hong Kong investors to invest on overseas markets without the protection of the Hong Kong regulatory regime.

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

We do not consider that the Exchange should impose an absolute ban on companies using WVRs for the reasons set out below.

Global competitiveness

In order for Hong Kong to remain a global financial centre, it is important for it to be competitive with other global financial centres. An absolute ban on WVRs would mean that Hong Kong would continue to be at a disadvantage to the United States. As the Concept Paper notes, a significant number of Chinese enterprises have chosen to IPO in the United States rather than listing in Hong Kong. As well as Hong Kong losing these listings, and the associated benefits for the local economy and local investors, it has also led to a situation where, in certain sectors, even Chinese enterprises without WVRs may regard the United States as a superior option to Hong Kong. We believe that it is important for Hong Kong to reverse this trend, and to find a way to bring these businesses to Hong Kong, making it Chinese enterprises' first choice of listing venue. We would strongly encourage the Exchange and the SFC to take this into account when considering the responses to the Concept Paper and formulating new rules. Hong Kong should be the world's gateway to China and therefore it needs to be able to attract and list the leading businesses coming out of China.

Looking to the future, Hong Kong needs to continue to internationalise to be seen as a true global financial centre, rather than a China hub. In order to be able to do this effectively, it will need to be able to compete with the US capital markets, including the ability to list companies with WVR structures, wherever located.

Investors' interests

We do not consider an absolute ban would be in the interests of the investing public in Hong Kong, which the Exchange is under a duty to have regard to under Securities and Futures Ordinance (Cap. 571) (the ***SFO***). The current effective ban reduces investor choice by preventing some investors from investing in companies that would otherwise choose to list in Hong Kong, while at the same time resulting in a situation where those investors who are able to invest in overseas listed securities are doing so without the benefit of the Hong Kong regulatory system (e.g. the connected transaction rules) or enforcement mechanisms and experience (e.g. the Exchange's and SFC's deep experience of dealing with PRC issuers, variable interest entities and controlled companies), and generally at greater expense.

We believe that investors' interests would be best served by giving them the choice to be able to invest in companies with WVRs, provided that (i) clear disclosure is made of the associated risks; and (ii) there are conditions and limitations on the scope of WVRs, our recommendations for which are set out below.

Strong existing safeguards

The Listing Rules provide strong protection for Hong Kong investors which would be equally applicable to companies with WVR structures. The rigorous listing process and continuing obligations imposed on listed companies and their directors ensure that companies are suitable for public investment at listing and continue to remain so after listing. Examples of existing safeguards include

stringent listing suitability requirements, a robust sponsor regime and extensive connected transactions restrictions which provide safeguards against the potential abuse of power and extraction of private benefits by connected persons, including substantial shareholders and directors.

Allowing WVRs is an incremental change consistent with the Exchange's long standing practice of providing Hong Kong investors with an investment choice that captures current market opportunities

We believe that allowing WVRs is consistent with the Exchange's evolutionary path over the past couple of decades to provide Hong Kong investors with an investment choice that captures current market opportunities. From being a market listing only domestic issuers, the Exchange has evolved to permit the listing of PRC companies, overseas companies and companies without a profitable track record, and even companies without a three year track record at all. It has also permitted the listing of companies in a broad range of sectors, in some cases pursuant to a specific regime / rule based dispensations and with a range of corporate structures, including notably variable interest entities. In each case, these changes have presented new risks for investors and the Exchange has addressed these risks by implementing enhanced rules, guidance and practices to ensure that investors are adequately protected. The Exchange has commendable track record of being highly aware of market developments and responding with continual incremental changes to ensure that new investment opportunities can be offered to Hong Kong investors. Permitting WVRs is a natural step in this evolution.

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

(iv) only in "exceptional circumstances" as permitted by current Listing Rule 8.11?*

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

New applicants vs. existing listed companies

We believe that WVRs should only be permitted for new applicants. Given the risks associated with a WVR structure, we believe that investors should only be investors in a company with a WVR structure if they have made a clear decision to do so. As the Concept Paper notes, investors in a company with a WVR structure at the IPO stage or in the secondary market invest with full knowledge of the risks of WVRs. This would not be the case if existing listed companies were permitted to adopt WVR structures, since shareholders who had purchased shares in a one share one vote structure company may find themselves shareholders of a company with a WVR structure (e.g. if a WVR structure could be adopted without needing the consent of all shareholders).

The Concept Paper notes that there is a risk that existing listed companies may attempt to circumvent a restriction only permitting new applicants to have WVR structures by conducting spin-offs of assets or businesses as new listed companies with a WVR structure. We would suggest that the Exchange address this risk by imposing an independent shareholder approval requirement (i.e. shareholders who would not benefit from the WVR structure within the new entity), possibly similar to that in the Takeovers Code and the Companies Ordinance for a privatisation by scheme of arrangement (i.e. not less than 75% of votes in favour and not more than 10% of total disinterested shareholders voting against), before such a transaction could be effected by an existing listed company.

Sector based limitations and requirement for companies to be 'innovative'

We do not believe that WVR structures should be restricted to companies in particular sectors or to companies which are 'innovative'. We consider that such a restriction would be arbitrary and not be justified either on the grounds of competitive position or investor protection. If WVRs were limited to businesses in the technology sector, which we acknowledge is currently the sector which makes the greatest use of WVRs, this may limit Hong Kong's competitiveness in the future if WVRs become prevalent in another sector. From an investor protection point of view, there is no correlation between the risk profile of a business and its sector. In addition, there may be considerable difficulty

in prescribing and applying a sector based restriction because in practice businesses do not always fall neatly into one or other sector 'bucket'. They could be even greater difficulty in applying an 'innovative' company requirement meaning that the test could become highly subjective in practice.

Size based restriction

We would suggest that the Exchange impose a minimum market capitalisation threshold. We would suggest setting the threshold at a relatively high level. Although this may exclude a number of potential issuers, it would not exclude the types of companies that we consider are the most important for the Exchange to attract to ensure it is globally competitive.

Exceptional circumstances exception

We support a defined regulatory framework consisting of clear rules setting out the permissibility of WVR structures and any related conditions and restrictions. The current "exceptional circumstances" exception is unhelpful as no company to date (other than 'golden share' companies such as Vale) has been able to fall within the exception, meaning that it is regarded by the market as effectively an absolute ban. In our view, the Listing Rules should be amended to permit WVR structures, with clear conditions and restrictions so that companies and their advisers are able to easily understand what is permitted and what is not permitted. Nonetheless, we would suggest retaining the exceptional circumstances exception in some form to provide the Exchange with the flexibility to allow the listing of companies with WVR structures falling outside the predetermined criteria, but which are nevertheless suitable for listing.

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?

If the Exchange were to permit dual class share structures, and WVR structures more generally, we would support the imposition of the following conditions and restrictions:

- Special voting shares to be limited to pre-IPO shareholders. We appreciate that a difficult question is who can hold special voting shares. In the US precedents, this is generally the founders/ initial management, and there are good arguments for why a WVR structure may be appropriate for such persons as set out in the Concept Paper. However, as a practical matter, it may be difficult to define this class of person for the purposes of a formal rule. An alternative approach would be to limit holders of WVRs to pre-IPO shareholders. Although this may enable some non-employee/ management shareholders to benefit from a WVR structure, in practice we would expect the extended lock up undertaking that we have proposed (see below) to limit the appeal, and therefore the use, of special voting shares outside employees and management. We would also propose that special voting shares be limited to the shares in issue or issued at the time of IPO[1]. Restricting special voting shares to pre-IPO shareholders and limiting them to the shares in issue or issued at the time of IPO would also ensure that ordinary shareholders' voting rights are not diluted post IPO by further issues of special voting shares.

- Lock-up requirement. Since the key justification for WVRs is to enable the company to be managed with a long term view and provide a degree of insulation from ordinary shareholders' short term interests, it would seem appropriate for pre-IPO investors holding special voting rights to be locked up from selling their shares for a longer period of time than is required for controlling shareholders – for example three years - and to be locked up even if they hold less than 30% of the company's share capital. If a shareholder does not want to be subject to such a long lock-up, it would be able to switch into ordinary shares at the time of the IPO and not benefit from special voting rights. We believe that limiting holders of WVRs to pre-IPO investors with a lock-up requirement would give investors an appropriate balance between the potential advantages of WVRs and the associated risks.

- Conversion to ordinary shares without special voting rights on a transfer or death/ incapacitation or bankruptcy. This is a natural consequence of the argument in the first bullet – once special voting shares are no longer owned by a pre-IPO shareholder[2], the shares should convert into ordinary shares (noting here that the Takeovers Code implications from the total number of voting rights decreasing significantly, resulting in increases in other shareholders' respective levels of interest in the total voting rights, will need to be addressed). Such a rule would also mean that, over time, the power of the special voting block would be expected to decline. This is consistent with market practice in the United States. We consider this

[1] Although we would expect to allow holders of special voting shares to increase their holdings in the event of an issue of new ordinary shares to maintain their percentage voting power – otherwise it would disincentive such companies to issue new equity capital which may not be in their interests.

[2] The Exchange would need to consider the extent to which a pre-IPO shareholder would be permitted to put its special voting shares into trust arrangements for the benefit of itself and associated persons or through any other method which effectively served to avoid a conversion to ordinary shares as a result of such circumstances.

approach to be preferable to WVRs being limited to a fixed period of time i.e. a 'sunset' clause.

- Minimum shareholding requirement/ limitation on special voting rights ratio. We have considered whether it would be appropriate to impose a minimum shareholding requirement on holders of special voting shares to ensure that their economic interests are sufficiently aligned with ordinary shareholders and to reduce the incentive to consume private benefits. We have concluded that this issue would be better addressed by imposing a limitation on the special voting right ratio (i.e. the ratio by which the special voting shares have additional votes to ordinary shares) rather than imposing an arbitrary minimum holding percentage that would apply regardless of the size of the special voting block held by a shareholder. In determining the appropriate ratio limit, the Exchange may wish to consider what percentage of the economic interest in a company a shareholder should be required to hold in order to have a majority of the voting rights.

- Different stock code. To ensure that investors are quickly and easily able to identify a company with WVRs without having to carry out further research, we would propose that companies with a WVR structure be required to have a stock code with a particular number prefix.

- Full disclosure. The listing document should prominently describe the WVR structure together with the associated risks. It should also provide examples of how the WVR structure will affect the ability of ordinary shares to pass resolutions at general meeting (and, where applicable, to do other things that are ordinarily vested in shareholders) compared to a one share one vote structure.

Question 4: Should other Weighted Voting Right structures be permissible, and, if so, which ones and under what circumstances?

We do not believe that the Exchange should limit WVR structures to dual class shares, provided that (i) the WVR structure is clearly described in the listing document; and (ii) it does not result in investors being subject to lesser protection than a dual class share structure, taking into account the conditions and restrictions we have described above.

For example, the Alibaba Group partnership structure arguably provides investors with better protection than a simple dual class share structure since it enables investors to vote down directors nominated by the partnership or remove them from office at subsequent general meetings, whereas in a dual class share structure, investors holding the ordinary class shares are generally not able to block the holders of special class shares appointing a particular director, nor are they able to remove directors.

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?

Changes to the Takeover Code would be required to determine the impact of a WVR structure on the provisions of the Code, including what would happen if and when super voting shares converted into ordinary shares. Otherwise, we do not believe that any changes are necessary, other than those outlined in our response to question 3, for the reasons set out below.

Changes in corporate governance and the Listing Rules

A significant proportion of the listed corporations in Hong Kong have a controlling shareholder who directly or indirectly owns 50% or more of the issued shares, or a sufficiently large holding to ensure de facto control. The Hong Kong investment community, the SFC and the Exchange therefore have ample prior experience of the risks associated with investing in companies with dominant shareholders, and the existing Listing Rules already provide investors with a very high level of protection against abuse of position by major shareholders and management. The Exchange and the SFC have deep experience in applying and enforcing these rules. In particular, Hong Kong has an extensive regulatory framework for connected transactions – arguably the most developed in the world, which is a direct result of the Exchange's considerable experience of dealing with connected transactions and controlled companies - which acts as a safeguard against the extraction of private benefits by connected persons, including substantial shareholders and directors, at the expense of other shareholders. In addition, Hong Kong's unique Listing Committee approval process provides investors with the protection of a highly experienced and expert group of individuals that new applicants must satisfy in order to be listed.

Class action regime

We do not think that it is necessary for Hong Kong to have a class action regime before it can allow weighted voting rights. The main benefit of a class action regime, from an investor protection standpoint, is to economise the process of securities litigation so that it is worthwhile for smaller investors to claim compensation in circumstances where if they made individual claims, the legal and other costs would make it uneconomic. Hong Kong already has an effective means for obtaining compensation for investors in an economical way, through the SFC powers discussed in the next paragraph below. Moreover, the SFC, as the statutory regulator, is arguably better placed to conduct securities litigation on behalf of investors in an efficient and effective way than legal counsel, who may have different motivations. The limited additional benefit of a class action regime would need to be set against the high likelihood to it would act as a significant disincentive to companies listing in Hong Kong due to the potential cost of defending and settling class actions – as it has done in the United States. Accordingly, we do not believe that Hong Kong requires a class action regime for securities litigation, and that if it were to have one, it would be likely to damage Hong Kong's global competitiveness.

Changes to the enforcement regime

As the Concept Paper notes, the Exchange, and particularly the SFC, already have a wide range of tools in their arsenal to deal with investors who are prejudiced by issuers or their management and shareholders acting in contravention of applicable laws and regulations. These include powers for the SFC to take action against companies and their management for unfair prejudice and market manipulation (including disclosure of false or misleading statements) and to obtain compensation for investors. The SFC has used these powers in a number of recent high profile

cases involving listed companies and obtained significant sums in compensation for investors. Although the Exchange does not have the same powers as the SFC to obtain financial compensation, it has similarly taken a number of recent actions against companies and their directors for breaches of Listing Rules, including those relating to directors' duties. Finally, as the Concept Paper notes, investors are also able to taken action in their own name under various statutory provisions. We therefore believe that Hong Kong already has a very robust enforcement regime and accordingly do not think that any changes are required to allow companies to use WVRs.

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

We do not believe that companies with WVRs should be required to list on a separate board. Save for the conditions and restrictions outlined above, we consider that companies with WVRs should be regulated under the same regime as Main Board listed companies. This would ensure a level playing field and that investors are able to easily understand the regime applicable to listed companies with WVRs, whereas a separate bespoke regime would have the potential to confuse investors for no clear benefit. We believe that requiring companies with WVRs to use a specific stock code prefix would provide investors with sufficient, and quick and easy notice of a company having WVRs. Accordingly, we see no justification for requiring companies with WVRs to be listed on a separate board.

(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?

We believe that overseas companies with WVRs wishing to list in Hong Kong should generally obtain a primary listing (including a dual primary listing if already listed overseas) so that they are subject to the full requirements of the Listing Rules, ensuring that investors obtain the maximum level of protection available under the Listing Rules.

However, we would not wish to exclude companies with WVRs which meet the minimum market capitalisation requirement we suggest in the response to Question 2 from obtaining a secondary listing in Hong Kong, particularly those with a global business that may not choose to list in Hong Kong if they can only do so a primary basis. It may be appropriate to impose a special entry requirement for such companies to ensure that investors are adequately protected notwithstanding the lighter touch rules afforded by the secondary listing regime. For example, a relatively short list of eligible primary listing exchanges and a requirement for the issuer to have a good compliance history. It may also be appropriate to impose the full weight of the connected transaction rules (which would not ordinarily apply to a secondary listing) if the issuer would not be subject to equivalent rules in their primary listing exchange, to address the risk of extraction of private benefits.

In addition, to prevent the potential risk of companies with WVRs obtaining a primary listing in an overseas jurisdiction first and then carrying out a secondary listing in Hong Kong to circumvent the need to obtain a primary listing in Hong Kong with the more onerous rules that would impose (i.e. if it listed in Hong Kong first), we propose that companies with WVRs seeking a secondary listing in Hong Kong should be required to have been listed on a suitable overseas stock exchange for at least three to five years. However, this minimum period should not apply for companies with WVRs already listed overseas at the time any formal consultation to amend the Listing Rules to permit WVRs commences, since the circumvention concern would not apply to such companies as it would not have been possible for them to list in Hong Kong at the time of their IPO.

Although our strong preference would be for companies with WVRs to be able to obtain a primary listing, if the Exchange concludes that this is not supported by the market, we believe that consideration should nevertheless be given to allowing companies seeking a secondary listing to use WVRs, subject to higher entry requirements as discussed above.

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

No