Part B Consultation Questions

Please reply to the questions below that are raised in the Concept Paper downloadable from the HKEx website at: [add link]. Please indicate your preference by ticking the appropriate boxes.

Where there is insufficient space provided for your comments, please attach additional pages.

We encourage you to read all of the following questions before responding.

1. Should the Exchange[1] <u>in no circumstances</u> allow companies to use WVR structures?

   ☒ Yes (in no circumstances allow companies to use WVR structures)

   ☐ No

   Please give reasons for your views below.

Please see separate sheet.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

2. Should the Exchange permit WVR structures:

   (a) ☐ for all companies, including existing listed companies; or

   (b) ☐ only for new applicants (see paragraphs 147 to 152 of the Concept Paper); or

   (c) only for:

      (i) ☐ companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162 of the Concept Paper), please specify below which industries and how we should define such companies;

[1] References to “the Exchange” in this Questionnaire mean The Stock Exchange of Hong Kong Limited, a HKEx subsidiary.

or

(ii) ☐ "innovative" companies (see paragraphs 163 to 164 of the Concept Paper), please specify how we should define such companies below;

or

(iii) ☐ companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons below;

or

(d) ☐ only in "exceptional circumstances" as permitted by current Listing Rule 8.11[2] (see paragraph 81 of the Concept Paper) and, if so, please give examples below.

Please give reasons for your views below.

[2] GEM Rule 11.25.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

3. If a listed 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 applied in the US (see the examples at paragraph 153 of the Concept Paper), or others in addition or in substitution?

   Please identify the restrictions and give reasons for your views below.

4. Should other WVR structures be permissible (see Chapter 5 of the Concept Paper for examples), and, if so, which ones and under what circumstances?

   Please give reasons for your views below. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

5. Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V of the Concept Paper)?

   ☐ Yes

   ☐ No

   If so, please specify these changes with reasons below.

6. Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of the Concept Paper:

   (a) using GEM, a separate board, or a professional board to list companies with WVR structures (paragraphs 33 to 41 of the Concept Paper); and

   (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47 of the Concept Paper)?

7. Do you have any other comments or suggestions regarding WVR structures?

- End -

Reasons for my answer to question 1

The concept paper is indeed extremely comprehensive. Credit should be given to the staffs of the HKEX who work on this paper. Most factors for and against the WVR structure have been clearly laid out with relevant background reports, studies and information appended. It is therefore a matter of attaching appropriate weights to these factors to achieve the right balance to maximize public interests.

I use the term "to maximize public interests" at the end of the last paragraph for a special reason. In the concept paper, it is mentioned several times that the HKEX is in competition with other exchanges in attracting listings. While this is certainly the case, I have strong reservation on strengthening the HKEX's attractiveness by lowering shareholders' protection. The HKEX is attractive to many issuers for reasons such as our good legal system, abundance of proficient market professionals, proximity to China, etc. It must be a difficult and painful decision for Alibaba to give up HK (as can be seen from its protracted discussion with the HKEX/SFC to make an exception for them). The SFC was perfectly correct to keep the Pandora's box shut.

Local investors who still wish to invest in companies with WVR structure and decide to list in another market have lost little. In this era, local shareholders are free (and easy) to invest in other markets which may not offer the same level of shareholders' protection as ours. However, Hong Kong's reputation as a well regulated market has its reputation to maintain. To me, a smaller market which only attracts properly managed companies is always preferably to one which tops the ranking in market capitalization, number of new listings, total annual funds raised, etc. Development of our financial market is much healthier in the long run.

I started working as a corporate financier in the mid 1980s and so witnessed the change from the dual share regime. It should be noticed that once the dual share structure was banned, there was a period (from the late 1980s to the 1990s) when controlling shareholders tried to achieve the same objective by building pyramid structures. Despite various arguments put forward (culture, continuity, long term vs short term performance, etc.), the key rationale behind the advocate of the WVR structure is "control", and more importantly control with the minimum amount of resources.

The question now is whether "entrenched control" good or bad for the company. My view is that it is 90% bad and 10% good. To tackle the "private benefits" issue alone, the listing rules on connected transactions have evolved from almost non-existence (when I first joined the industry and the entire listing rule book is about 30 pages long) to a "bible-like" chapter on this one particular issue. And yet, speaking with the experience of an ex-merchant banker and an INED for many companies, I can confidently say that the protection against "private benefits" is far from effective, and will continue to be so even if you double the length of Chapter 14.

The most effective safeguard against entrenched control is the ability to vote management out. Those who complain about under-valued hostile bids are mostly those who cannot create and maintain proper value for shareholders. The essence of obtaining a listing is that when the founder/controlling shareholder/manager is getting the benefit of using OPM to expand their business, they should at the same time accept the fact that they may be voted out if they fail to perform.

The local (perhaps with a strong Chinese tradition) market is already handicapped by the concept that the company, although listed, remained "the controlling shareholder's company" rather than a "public company". There is an argument, and probably a lot of truth, in the fact that such controlled companies do not face the same "agency problem" as in the US and most other markets when controlling stakes are an exception rather than the rule. But this only works when the controlling shareholder has a lot at stake, ie. he/she is heavily tied financially to the company. The WVR structure is giving them a perfect solution.

I have given thoughts on whether we should allow the WVR structure by imposing restrictions against its abuse. At the end, I think it is not worth it. We will end up with another 50-page chapter (and ever expanding to catch up with new ways to circumvent the rules) in the listing rules. Complicated structures (the deadly derivatives which almost caused a total collapse of the world market!) are always proposed with splendid reasons. In my own investment portfolio, I have only straight equity shares and bonds.