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Corporate and Investor Communications Department
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Dear Mr. Charles Li,

“Consultation Paper on a Listing Regime for Companies from Emerging and Innovative Sectors”

We refer to the above document, which was published on the Hong Kong Exchanges and Clearing Limited (“HKEX”) website on 23 February 2018.

Our Hong Kong Foundation (“OHKF”) has always been supportive of expanding the listing regime to introduce weighted voting rights (“WVR”) structures as a method of strengthening Hong Kong’s position as a leading international financial centre. In fact, two years before the current consultation, in our Economic Development Research Report titled “Yes, Hong Kong Can”, we have already put forward suggestions in support of and on safeguards for WVR structures (please refer to p.57 of the report for details:

https://www.ourhkfoundation.org.hk/sites/default/files/media/pdf/Yes_Hong_Kong_CAN_eng.pdf).

While OHKF concurs with HKEX’s objectives of attracting more listings, further establishing Hong Kong as an international asset management centre and staying competitive in the global capital market, we also believe that measures protecting minority shareholders should be in place to ensure that risks related to WVR structures are well-considered and under control.

The rationale underlying the WVR structure is that investors may have faith in the



founder or the senior management of a company, especially with regard to the strategy and future plans concerning the development of the company. Therefore these investors are willing to reduce their voting rights in exchange for smoother sailing and greater success of the company. Bearing this in mind, we would like to respond to Chapter 3 (*“Issuers with WVR structures”*) of the consultation paper with views and recommendations in eight areas as follows:

1. Enhanced disclosure

In this regard, we note that an enhanced disclosure arrangement should be in place. HKEX proposes the following requirements to alert potential investors on companies with WVR structures:

- A unique stock marker “W” at the end of the stock name for easy identification.
- Including the warning *“a company controlled through weighted voting rights”* on the front page of all Listing Documents.

We also note that the Singapore Exchange (*“SGX”*) has proposed similar requirements in their consultation on the dual class share structure.

We further propose that to better protect non-WVR shareholders, the following details should also be disclosed:

- Percentage of total shares WVR beneficiaries will be holding and the corresponding voting rights granted.
- Detailed provisions of the sunset clause including the specific expiration date of WVRs (discussed in Consideration 8).
- The situations upon which WVRs will terminate (e.g. upon the transfer or sale of any of the WVR shares).

2. Non-transferability of WVRs

We appreciate HKEX’s proposal that WVR shares should be converted into ordinary shares if the WVR beneficiary ceases to be a member of the board of directors or if the shares are transferred to another person or entity through



either sale or inheritance. Similar suggestions can be seen in SGX's consultation paper.

As aforementioned, investors oblige the founder or senior management to possess WVR shares because they have confidence in them. But if the latter were to sell their stakes in the company, there would be no justification for the continued existence of WVR shares, unless the other shareholders vote to re-grant the super-voting powers to succeeding shareholders at an annual general meeting ("AGM") or extraordinary general meeting ("EGM") (to be discussed in Consideration 5).

Therefore, we propose that holders of WVR shares should not, by any means, be permitted to exploit their WVRs for their personal economic benefit. This includes using WVR shares as collateral for loans. Consequently, we dissent from HKEX's proposal to convert WVR shares into ordinary shares if a pledge over the WVR shares is enforced. Any financial tools such as long put options which could reduce the effective quantity of company shares at risk to the WVR beneficiary should also be prohibited or at least require prior approval. To illustrate, if the WVR beneficiary holds 20% of total outstanding shares and long put options for 50% of them at the same time, his at-risk position in the company will decrease to 10%. As the WVR beneficiary has less at risk, he would be more likely to act at the expense of other shareholders. Hence using financial tools to lower WVR beneficiaries' effective at-risk shareholding should be banned. The principle should be that the controlling shareholder should at all times be the ultimate beneficiary of the shares owned. This will align the interests of the controlling shareholder and the company while also reducing moral hazard on the part of the controlling shareholder.

3. Prior notification of sales

Building on the previous considerations, we further recommend that prior notification for a certain fixed period of time (e.g. 31 days) should be required for any sale of the WVR shares by the WVR beneficiary. As investors cede their voting rights based on their trust in a particular WVR beneficiary, they should be given the right to opt out of the company before the WVR beneficiary sells his or her WVR shares in whole or in part, notwithstanding the fact that those



shares will be converted into ordinary shares. Therefore the maximum number of shares planned to be sold and the expected transaction date should be disclosed. However, there should be some allowance as to whether the stake is in fact sold and the exact number of shares to be sold depending upon the market situation on the expected transaction date, as long as it is within the disclosed maximum amount.

4. Protecting non-WVR shareholders right to vote

HKEX proposes to require the following key matters to be decided on a one-share one-vote basis and WVR beneficiaries will not be able to exercise WVRs on these matters:

- (a) changes to the issuer's constitutional documents, however framed;
- (b) variation of rights attached to any class of shares;
- (c) the appointment or removal of an independent non-executive director;
- (d) the appointment or removal of auditors; and
- (e) the voluntary winding-up of the issuer.

We believe that the voting power of WVR beneficiaries should be subject to some limitations. Therefore we support the above safeguards as they would play an important role in protecting non-WVR shareholders.

In addition, we suggest expanding the list above with two more matters which should be decided on a one-share one-vote basis:

- (f) the issuance of new shares; and
- (g) the buy-back of existing shares.

Furthermore, to better protect the voting rights of non-WVR shareholders, we recommend clarifying that item (a) requires all amendments of constitutional documents to secure at least a two-thirds or even three-quarters majority of the vote on a one-share one-vote basis.

5. Granting/re-granting of WVRs

We note that with good intentions to protect the non-controlling shareholders,



the HKEX proposes ring-fencing measures which will prohibit WVR companies from increasing the proportion of WVRs and existing listed companies from converting to a WVR structure. Although these measures have been adopted in Canada and the United States (“US”), we suggest a more flexible approach which allows investors to make the final decision.

We consider two scenarios in which companies might wish to be granted or re-granted WVRs. We suggest that companies should be required to provide reasonable justifications and move a resolution at an AGM or EGM which shall only pass with a vote of three quarters (or higher) of the shares not controlled directly or indirectly by the WVR beneficiary.

The scenarios are as follows:

- Scenario 1: Upon expiration of WVRs, either due to transfer of shares by sale or inheritance, or upon the sunset clause taking effect (discussed in Consideration 8), the WVR beneficiary or succeeding shareholder may wish to be re-granted WVRs.
- Scenario 2: The WVR beneficiary may wish to increase the proportion of WVR shares. This will require the conversion of ordinary shares owned by the WVR beneficiary into WVR shares. Additionally, in very special cases, a current listed company without a WVR structure might wish to adopt one (i.e. increasing the percentage of WVR shares in total shares outstanding from zero to a certain level). In such cases, HKEX should apply additional safeguards. Prior approval on the fitness of the proposed WVR beneficiary should be required by HKEX and decided on a case-by-case basis. A compelling justification, such as the retention of a chief executive officer, should be provided. In principle, HKEX should only accept reasonable justifications that the proposed WVR structure would produce future benefits for all shareholders of the proposing company, not just the WVR beneficiary. This is crucial in deterring WVR beneficiaries and potential WVR beneficiaries from using WVR structures as a device to procure personal advantages.

The safeguards discussed in the above Considerations should equally apply to



the re-granted WVR and converted WVR structures.

6. Companies Suitable to List with a WVR Structure

We believe that restricting the scope of eligible companies to “innovative companies” (or “new economy companies”) is unnecessary. Firstly, aside from “innovative companies”, other companies may have various considerations which justify their use of a WVR structure. Well-established companies from traditional industries such as Nike, Ford Motors, Berkshire Hathaway, Dow Jones Company and the New York Times use WVR structures and are listed on the New York Stock Exchange, while the same applies to Swire Pacific in Hong Kong.

Secondly, pragmatically speaking, it would be difficult to distinguish between “innovative companies” and non-innovative companies. A company in a traditional industry that is consistently profitable must undoubtedly be doing something innovative. Thus, instead of expending efforts trying to determine whether a given company is innovative or not, we believe it is better and simpler to let investors decide whether that company should be allowed to have a WVR structure, subject to the various safeguards mentioned above.

In addition, companies from traditional industries may have plans to tap into new economy areas, which might transform them into “innovative companies”. For example, some traditional financial institutions are stepping into the FinTech area, and may consider adopting a WVR structure. The proposed restriction to “innovative companies” is difficult to apply, prone to caprice and fails to account for the changing nature of industries.

7. Corporate WVR beneficiaries

We believe that companies, partnerships, consortia and groups should be ineligible as WVR beneficiaries for the following reasons:

- The ultimate beneficiary of the super-voting power would be unclear if a company is the WVR beneficiary. Again, investors’ willingness to accept disproportionate voting rights lies in their trust in the founder or current chief executive officer. If a corporate shareholder is eligible as a WVR beneficiary, then the ultimate control of the company can be changed by



shareholding alterations, without any changes to the WVR shares held by the corporate shareholder in the company or approval by the other shareholders. This effectively means that WVR shares become transferable through change of ownership in the shares of the corporate shareholder. We submit that this completely negates and circumvents the principle of non-transferability and disadvantages the non-WVR shareholders of the company.

- Moreover, allowing a corporate shareholder to be the WVR beneficiary may set the stage for a power pyramid. A corporate shareholder with WVR shares could wield a great amount of power with a relatively small stake. For example, if Person A is the WVR beneficiary of Company X, which is in turn the WVR beneficiary of Company Y through WVR shares in Y, Person A would be able to make major decisions in Company Y just by holding a small but controlling stake in Company X (and perhaps no direct stake in Company Y). In this case, the interests of the ultimate controller (Person A) may not align with those of the investors of Company Y, leading to potential moral hazard problems.

Given the above, we suggest that HKEX should exclude companies or groups as eligible holders of WVRs. Only individual(s) should be allowed.

8. Sunset clause

The sunset clause has been a controversial issue in the discussion of WVR structures. As an example, the US does not mandate a time-defined sunset clause. However, it is not uncommon for some companies to voluntarily adopt their own sunset triggers. For instance, Groupon has a five-year sunset clause after which its WVR structure terminates, while Yelp sets their sunset trigger at seven years. SGX has conducted a consultation on the adoption of the sunset provision, but has yet to make a decision.

We believe a sunset clause should be applied. The clause should set a specific expiration date for WVRs, e.g. 10 to 20 years from the date of grant. If the WVR beneficiary wishes to extend the validity of his WVRs, he or she should propose a resolution at an AGM or EGM on the matter (as discussed in Consideration 5). This way, investors would have the right to decide whether the WVR shares



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should continue to exist. Otherwise, WVRs will automatically terminate. If a sunset clause is adopted, the same safeguards discussed in the above Considerations should still be applied.

We sincerely hope that HKEX finds the above points helpful, and we welcome a meeting with you and your colleagues to elaborate on our recommendations if necessary. Should you have any queries, please contact [REDACTED], senior researcher at OHKF, by email at [REDACTED]

Sincerely,

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