
From: Judy Lam · >
Sent: 22 March 2018 17:25
To: response
Cc: Susan
Subject: Comments to HKEX Consultation Paper
Attachments: hkexconsultation2018.docx

Dear Sir/Madam

Please find attached my comments. I am pleased to explain/discuss my views if necessary.

Judy Tsui

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Principal Investigator to 2003 Consultancy Reports to Company Law Reform on Corporate Governance

Re: Consultation Paper

A Listing Regime for Companies from Emerging and Innovative Sectors

I welcome the proposal on the abovecaptioned. It is better late than never. I have been a corporate governance researcher since 1984 and was the Principal Investigator behind the three consultancy reports on corporate governance in 2003. I have been advocating the idea of the corporate governance committee since 2003. Finally, it is recommended for issuers with WVR Structure as they need to have strengthened governance to protect minority shareholders.

I have comments pertaining to the two Headings in the Consultation Paper:

Biotech Companies

I support the idea of having a new chapter on Biotech companies. This would signal to the world that HK as one of the major financial centres in the world, is ready, capable and able to deal with high growth companies in this sector. We have lost our competitiveness in the last decade and we have a lot of catching up to do.

However, I would caution that corporate governance for these innovative new sector companies be adequately specified. We do not wish to overly burden these high growth companies. But investors in this highly risky sector need to be well cautioned and protected. There are no special requirements for Corporate Governance Committee such as that for WVR Structure issuers in Chapter 3. At least there should be more disclosures on this with more stringent requirements than existing Corporate Governance rules to protect investors. Specifically, the membership of audit committees focusing on the expertise of independent directors and non-executive directors must be encouraged if not stipulated or required. In addition to the "traditional" monitoring and governance related committees as required by the HKEX, committees such as Business Strategy Committee needs to be encouraged to assist the high growth and innovative companies to achieve its vision and goals. Otherwise, the failures or delisting of these companies would backfire on the HKEX and HK as a major financial centre. So it is not just governance committees but strategy related committees that are necessary for these companies to be mentored and grow successfully.

I understand that the applicants need to be vetted by the Listing Committee of the HKEX. There needs to be members who are innovative, and visionary as well as those with specialized expertise. Otherwise, the implementation of these rules is stifled.

Are these companies not allowed to issue dual class shares? Chapter 3 forbids existing issuers.

Issuers with WVR Structures

There seems to be mixed evidence regarding the advantages and disadvantages for dual share listing as covered by this consultation paper. The benefits and advantages are clearly articulated.

It is necessary for entrepreneurs to have more voting rights in order to prevent/avoid hostile takeover. As I have said before, Hong Kong needs to compete with other markets such as Singapore to attract and protect successful innovators and entrepreneurs. Hong Kong already lags behind Shenzhen for over 10 years. Hence, our competitive edge being our legal system and free flow of capital for investors need to be preserved if not enhanced.

However, there are also disadvantages and issues of shirking that need to be avoided and investors need to be protected. As pointed out by the literature, entrepreneurs can shirk or act against shareholders' interests by engaging in short term non-value maximizing projects. To prevent this, corporate governance mechanism is the only solution. I am so pleased to see that my recommendation to establish corporate governance committee in the 3 consultancy reports (2003) to the Standing Committee on Company Law Reform chaired by Justice Rogers is finally seeing the light of day. I obviously strongly support this recommendation. I also strongly support Chapter 3 paras.29-32. I would even go further to recommend a mandatory training programme for directors on risk management and their duty to protect all shareholders. A pass or fail is recommended on such course.

In addition, I also recommend that an independent consultant based on a list of qualified consultants approved by HKEX to conduct evaluation and assessment of directors to discharge their fiduciary duties in these WVR issuers. This will strengthen corporate governance as well as ensure that the controlling shareholders (typically the founders) will act in the interest of all shareholders.

To prevent the controlling founders/shareholders/managers to shirk, an additional requirement would be to require to set up a Remuneration Committee with the majority of members being independent non-executive directors and chaired by one INED too.

The above is consistent with the following papers which have strongly recommended that either the law or regulation be enhanced in order to prevent negative effects resulting from dual classes of shareholdings.

The above is also based not only on my research studies and those of others but also based on my practical experience throughout the last 15 years as INED. It is most important that the tone at the top is set right. These mechanisms help management to reduce possible negative results to a minimum. It is not only the monitoring mechanism that needs to be in place but also business strategy and business model innovation that needs to be constantly updated and enhanced to ensure all shareholders enjoy maximum values including economic, social and environmental.

References for Comments on Chapter 3

The Anatomy of Dual Class Share Structures: A Comparative Perspective by Shen J. Hong Kong Law Journal, 2016, V46 n part 2, p. 477-510.

Dual-Class Capital Structures: A Legal Theoretical & Empirical Buy-Side Analysis by Christopher C. McKinnon Michigan Business & Entrepreneurial Law Review 2016 Volume 5 Issue 1.

Corporate Governance and Firm Value at Dual Class Firms by Ting Li and Nataliya Zaiats, *Review of Financial Economics*, 2018; 36; p.47-71.

Agency Problems at Dual-Class Companies by Ronald W. Masulis, Cong Wang and Fei Xie. *The Journal of Finance* Vol.LXIV, No 4 August 2009.

Disproportionate Insider Control and Board of Director Characteristics by Lindsay Baran and Arno Forst, *Journal of Corporate Finance* 2015 35 p.62-80.

Corporate Payout Policy in Dual-Class Firms by Bradford D. Jordan, Mark H. Liu and Qun Wu 2014 26 p.1-19.