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Dear Sirs

**Re: Emerging and Innovative Companies CP**

We welcome the opportunity to respond to the Exchange's consultation on a listing regime for emerging and innovative companies (the **Consultation**). Fidelity International is a global institutional investor with over US\$400bn in total client assets and is an active investor in the Hong Kong market.

As we previously communicated in our response to the New Board Concept Paper dated 18 August 2017 and our response to the Concept Paper on Weighted Voting Rights dated 24 November 2014, Fidelity International is opposed to the introduction of weighted voting rights. We are pleased that the Exchange recognizes in the Consultation that the "one share, one vote" principle continues to be the optimum method of empowering shareholders and aligning their interests in a company". It is therefore disappointing that this fundamental principle has now been compromised. As an investor, one of the key value propositions of a Hong Kong listing is a regulatory framework which addresses the concerns of minority shareholders in controlled corporations commonly found in Asia. Part of this framework - including regulatory certainty, transparent and objective decision making, centre of gravity and one-share one-vote - is being compromised in the desire to attract new listings. Over the long term, we are concerned that there will be long term implications for the quality and reputation of the Hong Kong market.



That said, we understand Hong Kong's concerns around competitiveness and desire to foster market development. The decision has now been taken to proceed with weighted voting rights (WVR) in Hong Kong. The focus of the Exchange should now be to implement a clear eligibility framework and sufficient safeguards for all investors to preserve the long-term integrity of the market.

## **1. Biotech Companies**

We are supportive in principle of a listing framework of "pre-profit" biotech companies which do not meet the financial eligibility test, including those with no record of revenue or profit. Nevertheless, the high risk of failure of these companies if they do not achieve their concept creates a potential for shell companies to develop and therefore a rigorous approach to delisting is required. The Exchange will need to be vigilant to ensure that these companies are not inappropriately re-purposed for alternative activities.

These companies will typically not be at a stage of development which is currently regarded as being suitable for public market investors, including retail investors. It is common for venture capital and private equity investors in such enterprises to negotiate enhanced investor protections, including board seats, reserved matters and liquidation preferences. Whilst some of these are not replicable in a public company context, it highlights that there is generally a desire for these companies to operate under closer supervision and more robust governance structures. We appreciate that the Exchange has considered the need for enhanced disclosure requirements in the framework. However, there is scope to consider further measures to protect minority investor interests, for example, to ring fence the independence of independent directors by ensuring that they are voted on by independent shareholders only.

## **2. Issuers with weighted voting rights (WVR) Structures**

### **(a) Eligibility framework**

As with the framework for biotech companies, many of the key qualifications and definitions for WVR issuers - such as "innovation", "new technologies", "unique features" and "sophisticated investor" - have not yet been established. The Exchange proposes to rely on guidance letters to describe the key characteristics of potential listing applicants and makes clear that suitability is assessed on a 'case by case' basis. The lack of regulatory clarity is a



concern for issuers and investors alike and we urge the Exchange to release the relevant guidance as soon as possible. We have a more fundamental concern that some of these concepts will at best be principles based and require the Exchange and the Listing Committee to exercise a high degree of subjective judgment in their interpretation. This is a significant departure from the commitment to rules-based decision making which has benefited Hong Kong to date.

We also express concern about the inclusion of a "sophisticated investor" as a key eligibility criteria for WVR and biotech companies. We observe that private companies seek external funding in different ways and for different reasons; and equally investors make investment decisions for different reasons. We caution against drawing undue conclusions from the presence or absence of so-called "sophisticated investors" as a way to validate the business model of a potential applicant. In our view, there is no substitute for the Listing Committee doing its own due diligence and analysis of biotech or innovative concepts, research & development, milestones and patents and licenses in order to correctly apply the Exchange's suitability guidelines. Over time, this may require additional Listing Committee members with specialist skillsets to address new demands.

#### **(b) Nature of the safeguards**

At the outset, we express disappointment that some of the most important safeguards - such as a time-limited sunset clause - are ruled out for consideration at the outset due to competitiveness reasons. These clauses are becoming governance best practices for certain US WVR issuers alive to the risks of WVR in perpetuity. To the extent that broad market support for safeguards is sought, we would have preferred a different approach in consultation and dialogue than the accelerated nature of this consultation process.

- **One share one vote on key matters:** we welcome the reservation of key matters on a one share one vote basis, and we broadly agree with the categories which the Exchange has selected. We would add, however, that minority shareholders are disenfranchised not only through changes in class rights but also through dilution of existing holdings. We urge the Exchange to include primary share issuance (specific and general mandate) to the list of key matters. On other matters where WVR rights are deployed, we recommend that the Exchange mandate disclosure of voting results on the basis of both the actual votes cast across all classes and, separately, votes cast on a pro forma "one share one vote" basis. Whilst this will not have a



practical impact on the outcome, the enhanced disclosure can serve to highlight instances where WVR holders are using their voting rights to obtain outcomes which non-WVR holders have judged to be against their interests.

- **Ring-fencing:** we welcome the general anti-avoidance rule to ensure that only new applicants will be able to list with the WVR structure together with a limit on the use of the WVR structure at the IPO only. While this will help erosion amongst the existing listed base, it cannot prevent it entirely. In particular, allowing IPO spin-offs by existing listed companies to use WVR is an obvious and legal way to circumvent this ring-fencing and will result in long term value leakage from one-share one-vote companies to WVR companies.
- **Transfer restrictions:** we welcome a restrictive set of permitted transfers designed to ensure that individual WVR holders have flexibility for tax and trust planning purposes but not to circumvent the general transfer restriction itself. The general transfer restriction underpins the basis upon which the Exchange has stated to be a reason for the introduction of WVR - to recognize the contribution of founders and key executives to the development of the company and their importance to its future growth.
- **Limits on WVR powers:** whilst we appreciate a theoretical upper limit on WVR power at a ratio not exceeding ten times, the reality is that at that limit, there is very little in practice that non-WVR shareholders will be able to vote on which will have anything other than symbolic value. We also highlight that a ten times ratio means that an individual can maintain control of a company and its board with as little as 5% economic interest in the company itself. We consider that an upper limit of five times ratio would be more reasonable in the circumstances.
- **Board governance:** historically, independent directors in Hong Kong have had limited impact on issuers due to the controlled nature of many corporations. It is not clear why this will change in an era of WVR companies absent a more fundamental review of the definition, election, composition and responsibilities of independent directors. Nevertheless, crucial elements of WVR safeguards will rest upon the ability of independent directors to ensure that a company is run for the benefit of all its shareholders, not just the holders of WVR rights.



- **Enforcement:** notwithstanding the Exchange's requirement for safeguards to be part of the issuer's constitutional documents to facilitate private legal action, we consider the opportunities for this to be limited in the context of Hong Kong's legal environment and remedies available to minority shareholders. Historically, minority shareholders in Hong Kong have relied on regulators taking action against corporate malfeasance. This reliance will become more important in the era of WVR structures, due to the fundamental misalignment of economic and control rights of a company creating greater risk of governance failures and where the safeguards have been overridden (for example, the Exchange monitoring and compelling an individual who has ceased to be "active" in the business to surrender their WVR rights).

### **(c) Corporate WVR beneficiaries**

We note with concern that the Exchange proposes to consult again on the possibility of allowing for corporates to hold WVR rights. In our view, this is not reflective of the Exchange's stated key characteristics for WVR applicants, that "each WVR holder has been materially responsible for the growth of the business, by way of their skills, knowledge and/or strategic direction where the value of the company is largely attributable or attached to intangible human capital."

Extending the franchise of WVR to corporates allows for the creation of WVR rights in perpetuity, removing any association with individuals who have contributed to past and future developments of the issuer. Over time, as public companies mature and previous "innovations" become settled features of society, it is natural to expect a company's reliance on a single or group of individuals to reduce and for the importance of professional management teams to rise. A permanent WVR structure can undermine this natural business cycle. Corporate WVRs can become traded entities themselves, creating a secondary market for "control ownership" as distinct from economic ownership and undermining the existing Takeovers Code.

### **3. Secondary Listings of Qualifying Issuers**

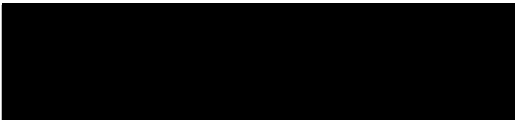
As a point of principle, we consider that any company listing in Hong Kong - primary or secondary - should offer equivalent shareholder protection standards for Hong Kong investors. Secondary listings should not become a way to undermine the quality of investor protection in Hong Kong generally. We appreciate that the Exchange is attempting to



mitigate this through the application of "Key Shareholder Protection Standards" but we believe these standards need to be significantly enhanced and at a minimum, address the key investor concerns of related party transactions, privatization rights and pre-emption rights.

Finally, we wish to note the recent statements from the China Securities Regulatory Commission concerning incentives for large US-listed Chinese issuers to seek secondary listings on the Shanghai Stock Exchange together with the response from the Singapore Exchange that they will also allow similar WVR structures on their Main Board. These developments illustrate, in our view, that any competitive move by the Exchange as a for-profit entity to attract new listings is likely to be met with a response from other market operators. In our view, the Exchange is better served by maintaining its clear leadership on governance and investor protection standards which have attracted, and continue to attract, global investors to the Hong Kong marketplace.

Yours faithfully



Jenn-Hui Tan

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