



Hong Kong Investment Funds Association

(company incorporated with limited liability 有限責任公司)

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March 23, 2018

Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central, Hong Kong

Dear Sir/madam,

**Re: HKEX consultation paper on Emerging and Innovative Companies CP
(issued in February 2018)**

On behalf of the Hong Kong Investment Funds Association (Appendix 1 for the backgrounder), I attach a submission that outlines the views and suggestions of the fund management industry (Appendix 2) with respect to the captioned consultation paper.

We wish to reiterate that as a principle, we have reservations and concerns about the introduction of the Weighted Voting Rights structure ("WVR") to Hong Kong as we generally believe that "one share one vote" is a cardinal principle to protect investors interests and a lynchpin of corporate governance.

However, as the introduction of this structure to Hong Kong is a fait accompli; we hope to contribute positively to help develop a framework that can accord as much protection to non-WVR shareholders as possible.

We appreciate that as the new economy sector is deemed to be a key driver for growth in the future and that different stock exchanges are vying for this segment, there is pressure to come up with a regime that would be sufficiently attractive to these companies. The competitiveness of the regime thus has been front and center when the HKEX designs the framework. We acknowledge that the HKEX has indeed put in much effort to try to strike an appropriate balance.

However, we believe that the WVR framework, as it currently stands, tips in favor of the issuers. Certain rights that minority shareholders currently enjoy – one-share-one vote, regulatory certainty and objective decision making and center of gravity – are being compromised; and it is imperative that there should be measures to balance this out to so as provide a minimum level of protection to non-WVR shareholders. Against this backdrop, we have proposed, inter alia, measures to:

- greatly enhance disclosures
- increase the percentage of INEDs and more clearly define the roles of INEDs so as to enhance accountability; and
- introduce other mechanisms (both immediate term and longer term ones) to bolster protection.

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For details, please see appendix 2.

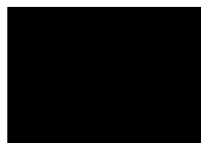
Some quarters have argued that if potential investors are concerned about the risks, they can stay away from this sector. However, it must be noted that if these stocks are included in the major or other relevant indices, passive managers are almost invariably obliged to invest in them. Even for active managers, they would be under pressure to buy into these stocks for diversification, portfolio construction and other reasons.

What is more important, the changes would not only have relevance to stock investors, but to all the two million plus working population in Hong Kong. Under the MPF regime, there are dedicated HK equity funds. In addition, there are other categories, such as regional funds or mixed asset funds which would potentially have exposure to these stocks.

Thus, there is a much broader dimension to the debate, as it has implications to the retirement nest egg of the Hong Kong population. Having a robust and sound framework to protect the interests of investors is thus paramount. We note that in the past few months, the official narrative is about the missed opportunities for the Hong Kong market; but we believe that there should be more discussions about the risks inherent in the WVR structure and the emerging and innovative sectors. And the news of late regarding some of these stocks, albeit idiosyncratic, probably is a timely reminder of the risks and volatilities of these sectors and the WVR structure.

We welcome the opportunity to further discuss our thoughts and suggestions. Ultimately, we wish to contribute positively to the discussions so as to help develop a robust framework that can accord a minimum level of investor protection. We believe that striking the appropriate balance is important as Hong Kong is probably the first international financial centre to come up with a comprehensive set of rules and standards on this subject; and it is imperative that we set a high benchmark that can maintain the long-term integrity of the market; and commensurate with Hong Kong's position as a premier financial centre.

Yours sincerely



Sally Wong
Chief Executive Officer

c.c.: Mr. Paul Chan, GBM, GBS, MH, JP, Financial Secretary
Mr. James Lau, Jr., JP, Secretary for Financial Services and the Treasury
Mr. Ashley Alder, JP, CEO, Securities and Futures Commission
Mrs. Diana Chan, JP, Deputy Chairman and Managing Director, Mandatory Provident Fund Schemes Authority

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Appendix 1

Hong Kong Investment Funds Association - Introduction

The Hong Kong Investment Funds Association ("HKIFA") is an industry body that represents the fund management industry in Hong Kong. It was incorporated in 1986 as a company limited by guarantee.

The HKIFA has two major roles, namely consultation and education. On consultation, it acts as the representative and consulting body for its members and the fund management industry generally in all dealings concerning the regulation of unit trusts, mutual funds, retirement funds and other funds of a similar nature. Towards this end, it reviews, promotes, supports or opposes legislative and other measures affecting the fund management industry in Hong Kong. Another very important task is to educate the public about the role of investment funds in retirement planning and other aspects of personal financial planning.

The HKIFA has four categories of members, namely full member, overseas member, affiliate member and associate member. A fund company can qualify as a full member or an overseas member if it is either the manager or the investment adviser of at least one Investment Fund.

An "Investment Fund" means

- an authorized unit trust/mutual fund; or
- a pooled retirement fund authorized under the Code on Investment-Linked Assurance Schemes or the Code on Pooled Retirement Funds; or
- a retirement scheme registered under the Occupational Retirement Schemes Ordinance; or
- a provident fund scheme registered under the Mandatory Provident Fund Schemes Ordinance; or
- a closed-end investment company listed on a recognized exchange.

A full member must be a company incorporated in Hong Kong or if it is incorporated outside Hong Kong, has established a place of business in Hong Kong whereas an overseas member must be a company incorporated outside Hong Kong.

An affiliate member is a company that has obtained a licence from the Hong Kong Securities and Futures Commission for type 9 regulated activities or it is a fund company incorporated in the People's Republic of China; and its primary business is fund management including the management of discretionary accounts, segregated portfolios or providing investment management services for non-collective investment schemes or the manager or investment adviser of any fund investment company or arrangement not included as an Investment Fund.

An associate member is a company conducting or providing any service of accounting, legal, trustee, custodian, administration, banking, distribution, and technological support to the fund management industry or any related professional services.

<http://www.hkifa.org.hk>

HKEX Consultation Paper on A Listing Regime For Companies From Emerging and Innovative Sectors - HKIFA members' views/comments (March 2018)

(A) Issuers with weighted voting rights ("WVR") structures:

1. Eligibility

Based on the consultation paper, it seems that there is a very high degree of discretion by the HKEX in determining what constitutes "innovative" "new technologies" and "new business model". (The HKEX states that qualifying companies are not guaranteed to be accepted for listing. Approvals will only be given "if the applicant fits the targeted profile". Just because an entity meets the qualifying criteria does not automatically imply that it will receive listing approval.) While we appreciate the need for flexibility, this may mean that there will be much subjectivity and uncertainty in the approval process. It seems that the application will very much depend on the Listing committee ("LC")'s ability to pick the suitable ones.

To increase transparency, predictability and rigor to the approval process, we would exhort the HKEX to, subject to confidentiality requirements, provide examples on a timely basis to explain the rationales for accepting and/or rejecting an application; so that the market can better understand the criteria that the authorities adopt to determine suitability. As the role of LC will become even more important under the revamped regime, we also wish to understand how the LC will gear up for the changes (e.g. how to engage experts with the relevant technical and industry knowledge), so as to enable it to discharge its responsibilities fairly, professionally and in the best interests of investors.

2. Safeguards

Under the WVR structure, certain key investor protections are compromised. Even though there is cap on the WVR ratio of ten times, for most of the important items (especially relating to the operation of the company), there is very little in practice that non-WVR shareholders can vote on which will have any effects.

In view of the limitations, we believe there should be balancing measures to ensure that non-WVR shareholders can be accorded a minimum level of protection, as detailed below. These requirements should be applicable to bio-tech and secondary listed companies.

a. *Independent Non-Executive Directors ("INEDs"), Nomination and Corporate governance committees -*

- Issuers with WVR structure should have 50% or more of INEDs on the Board, and there should be a lead INED as a dedicated point of contact for non-WVR shareholders.
- Issuers with WVR structure should set up a Nomination Committee and a Corporate Governance Committee; and both should be fully independent. For nomination of INEDs, WVRs beneficiaries can nominate candidates. But they as well as the

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management of the Issuer, and their associates should abstain from voting in the election of INEDs.

- Issuers should be required to appoint a third party Compliance Adviser.
- At the AGM, the lead INEDs and/or other INEDs, should provide an assessment of the effectiveness of the WVR structure and the reasons and conclusions of such an assessment. They should report on corporate governance issues identified in the reporting period, deadlines set, actions taken by the committee members, outcomes of their actions and progress made. They should also report on key compliance matters as advised by the third party Compliance Adviser. All these should be provided in details in the Annual Report, too.

b. Other safeguards -

- Lower the minimum stake requirement for non-WVR shareholders to call for a general meeting and to add shareholder resolutions. The proposed 10% threshold is too high. Other key jurisdictions, such as Australia and UK have a lower threshold - at 5% of voting rights; and we believe that we should also adopt the 5% threshold so as to balance out the rights that have been compromised.
- Provide a platform for non-WVR shareholders to express their views on the performance of those with WVRs (e.g. through an annual vote-of-confidence and votes would be casted on a OSOV basis.) Even though this is non-binding, this will provide a positive feedback loop to the founders and management about the views of non-WVR shareholders.
- Introduce a time-defined sunset (say after five years, and thereafter the WVR can still be continued, but subject to a vote based on OSOV). There is evidence to suggest that whatever advantages accrue from WVR tend to recede over time. Similarly, the costs of entrenchment tend to rise over time.
- Add the following to the list of matters that will be voted on a OSOV basis: primary share issuance (specific and general mandates)
- There are concerns that allowing IPO spin-offs by existing listed companies to use WVR provides a loophole for companies to circumvent the ring-fencing restrictions. The key concern is that post listing transactions could result in the transfer of a significant proportion of existing listed businesses and assets to WVR structures, and thus result in value leakage from OSOV companies to WVR structures. Also, there are questions such as how will the Takeovers Code be applied. These issues are important for the integrity of the market and HKEX should provide more clarity on these areas.

c. Disclosures -

To counter-balance the compromised investor rights, we believe that the authorities should prescribe more timely, prominent and detailed disclosures, including, inter alia:

- the numerical relationship between the amount of equity or its equivalent economic beneficial ownership interest held by each WVR beneficiary and the amount of voting rights held or controlled by such a person,
- where resolutions are not voted on a OSOV basis, companies should disclose (i) the voting result calculated by taking into consideration votes cast across all classes (incl WVRs and non-WVRs), and (ii) the voting result calculated on a OSOV basis. While the second result is only for reference purpose and would not affect the outcome, this serves to openly reflect the opinions of non-WVR shareholders,
- the company's ties with the Research and Development ("R&D") team: Given the strategic importance of the R&D function of these companies, the stability of the team is important. Departure of key personnel or other significant changes to the team can pose a threat to the company's growth prospect and even its viability. Investors wish to understand how a company has 'locked in' its R&D personnel expertise to assess the company's ability to sustain returns from its R&D function. Thus, information that can throw light on this should be mandated (e.g. team structure, incentive structure).

d. Corporate WVR Beneficiaries -

- We have huge reservations about allowing corporate WVR beneficiaries as this is seen as a major attempt to further dilute the principle of OSOV.

The current framework states that WVR beneficiaries will be restricted to individuals who are directors of the issuer at listing and will remain directors thereafter. The WVR rights will lapse permanently if a beneficiary dies, ceases to be a director, is incapacitated, or is otherwise deemed ineligible to continue. These rights are not permanently endowed and cannot be transferred to other person in the event that the individual holding them decides to sell. It further clarifies that "WVRs held by beneficiaries who are natural persons should naturally fall away over time". This is an important limitation on these rights since they are specific to the person who has made a significant contribution to the founding and growth of the business.

By suggesting these rights can also be held by a Corporate entity implies that these rights will be able to exist in perpetuity. By limiting the WVR rights to individuals actively involved in the company at least suggests there is a finite limit to the exercise of these rights. However, it is questionable how this can be avoided with a Corporate WVR holder unless sunset clauses are permitted. But the HKEX has already ruled this option out.

Allowing Corporate beneficiaries would open up a whole raft of issues, such as the application of the Takeovers Code. Furthermore, there is the potential risk that Corporate WVRs can become traded entities themselves, creating a secondary market for "control ownership" as distinct from economic ownership.

- If the HKEX maintains that it must introduce this structure, we strongly believe that there should be thorough consultations because it has major ramifications. Such a consultation should be conducted at the earliest 12 months after the WVR comes into effect (and there should be a minimum of a 3-month consultation period). Even just with individual beneficiaries, there are already a range of

implementation challenges and uncertainties. We need at least a year or so to see how the revised regime works and how the Listing Rules get transposed in practice, e.g. how the HKEX determines whether a company is innovative or not; and how it defines suitability; and how the new/revised chapters interact with other rules/regulations.

(B) Biotech companies:

- As the HKEX has rightly pointed out, a key risk is that the nature of the industry cycle creates potential for shell companies. The HKEX has proposed measures to mitigate the related risks (e.g. issuers not allowed to engage in transactions that would result in a fundamental change to the principal business). We wish to understand practically, how does the HKEX plan to monitor these companies so that they would not be re-purposed for other activities.

In addition, there are still concerns that there is still a risk of biotech companies being used to acquire "biotech" shell companies. For instance, how about if these companies acquire companies that are biotech in name or nature but have very poor asset quality and provide little visibility into their production pipelines? We suggest that the suitability test detailed in para 74 also applies to assets that listed biotech companies are considering acquiring post-IPO.

- On the list of competent authorities, we would suggest that, in addition to the three prescribed, the HKEX can consider adding Japan's Pharmaceuticals and Medical Devices Agency to the list, as it is a founding regulatory member of the International Council for Harmonization of Technical Requirements for Pharmaceuticals for Human Use. www.ich.org

(C) Waivers for Secondary Listings:

- The proposal to require Non-Greater China Issuers or Grandfathered Greater China Issuers seeking a secondary listing in Hong Kong to meet the Key Shareholder Protection Standards set out in Section 1 of the 2013 JPS is helpful.

However, what is concerning is that the Paper also states that "Non-Greater China Issuers and Grandfathered Greater China Issuers will be eligible to secondary list with ***their existing WVR structures and will not have to comply with the proposed ongoing WVR safeguards except for those that are disclosure requirements***". This effectively means that not only will these companies be exempt from restrictions on increasing the number or proportion of WVR shares after listing and from requirements on voting for certain matters on a OSOV basis, but they will also not be subject to rules requiring affiliated parties to abstain from voting with regards to connected party transactions.

Thus, just by applying the "Key shareholder protection standards" to secondary listed companies would not suffice. It is imperative that HKEX addresses the risks associated with connected party transactions, privatization rights and pre-emption rights.

- Overall, we are concerned that investors of secondary listings remain in a very vulnerable position in the proposed structure. Non-WVR shareholders will lack access to class actions should they be treated unfairly resulting in negative impact

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on shareholder value. Investors in the primary market of the US can bring class action lawsuits if they are treated unfairly, however, investors in the secondary market of Hong Kong can neither initiate a class action nor participate in class action lawsuits initiated by investors in the US.

In fact, even if these companies become primary listed in Hong Kong upon "migration of the bulk of trading", investors in Hong Kong are precluded from partaking in class actions when faced with corporate governance issues. Waivers allowed for these secondary listings will therefore expose investors in Hong Kong to a whole host of risks.

- We believe that the SAR Government should legislate to allow the introduction of class actions. We understand that there were opposition and reservation when the subject was discussed by the Laws Reform Commission a few years ago. However, we believe that it would be opportune to revisit this subject as class actions can enable efficient, well-defined and workable access to justice.
- On the migration of the bulk of trading, members suggest that the HKEX also takes into account the local free float metric alongside the total trading volume. Thus, it would be useful to amend as follows, either of the below would trigger an upgrade of a SLC to become a primary listing in Hong Kong:
 - a) if 55% or more of the total trading volume of those shares over the issuer's most recent fiscal year takes place on the Exchange's markets; *or*
 - b) if 55% or more of the trading volume of those shares within the local free float over the issuer's most recent fiscal year takes place on the Exchange's markets.

(END)