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Date

27<sup>th</sup> March 2018



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Dear Sir/Madam

### **Re: Emerging and Innovative Companies CP**

Legal & General Investment Management (LGIM) is one of the largest international investors with over USD 1.36 trillion of assets under management (as at 31 December 2017)<sup>1</sup>. We manage assets for a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

In Hong Kong, LGIM is a significant investor with over USD 4.8 billion of equity invested in the region in our index funds. Furthermore, we have a growing presence demonstrated by the recent expansion of our trading and index fund management arm in Hong Kong. Our strategic commitment is long term and aimed to provide the best solutions for our clients.

As a significant investor, there is a responsibility to ensure that global markets operate efficiently and uphold the highest level of governance standards to protect the integrity of the market over the long term. Therefore, the opportunity to respond to the consultation by the HKEX regarding the 'Emerging and Innovative Companies' is very important to LGIM.

LGIM believes that this is an opportunity for the HKEX to differentiate itself and become a leading global stock exchange for all market participants. In our previous submission, we highlighted our concerns with the New Board Concept and Weighted Voting Rights. Whilst our views on this issue still remains, we would like to have a constructive dialogue with the HKEX to explain our concerns.

As a regulator, the HKEX should demonstrate its high standards by upholding and valuing shareholder rights and investor protections. There is a risk that if certain mitigation steps are seen as best practice, these could be widely adopted in other markets. The HKEX has a duty to market participants to ensure that the impacts of its proposals are thoroughly considered.

We have outlined four key areas which warrant further attention:

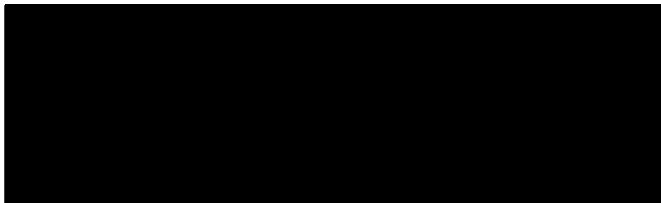
#### **1. Competence and Ability of Listing Committee to Determine Eligibility**

<sup>1</sup> Including derivative positions and advisory assets. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor.

2. Two-tier voting regime in Hong Kong
3. Time-based sunset provision; and
4. Enhanced Corporate Governance framework for issuers with WVR

In our response, we hope that we have been constructive in suggesting further improvements and remain at your disposal should you wish to discuss any of the points we have raised in further detail.

Yours sincerely,



Sacha Sadan  
**Director of Corporate Governance**  
**LGIM**

## APPENDIX:

# LGIM response to HKEX consultation on Emerging and Innovative Companies

### ISSUERS WITH WEIGHTED VOTING RIGHT STRUCTURES

#### Introduction

As we have mentioned in our previous submission to the HKEX on the New Board Concept, LGIM still has concerns with the introduction of WVR structures for issuers in the Hong Kong market.

LGIM acknowledges that HKEX is trying to attract good quality and high growth companies but this should not be at the cost of lowering governance standards in the market. Furthermore, the HKEX agrees that the “one share one vote” principle is the optimum method of empowering shareholders and aligning their interests in a company.

Therefore, we believe that rules and regulations being introduced should protect the interests of public investors first and ahead of any commercial interests.

Recognising that these proposals may still go ahead, however, we have outlined four important considerations we would like the HKEX to implement in order to strengthen its framework and maximising the protections to minority investors:

#### 1) Competence and Ability of Listing Committee to Determine Eligibility

As it stands, the current proposals from the HKEX heavily rely on the ability of the Listing Committee to make commercial judgements on the suitability of businesses to be eligible and list under the different profiling of innovative companies. This discretionary approach is a result of the problems with defining what an innovative company is and how the issue of technologies evolving with business structures makes identification a subjective exercise.

We have concerns with the discretionary approach taken by the HKEX to allow the Listing Committee to decide whether innovative companies to list in Hong Kong. It gives the impression that the Listing Committee will be “cherry picking” which companies can and cannot be listed without any clear direction of how final decisions are made.

We also note that the Listing Committee will review the facts and situation of each case to determine whether an applicant has demonstrated it is an innovative company. We question whether the Listing Committee has the suitable skills, knowledge and experience to recognise the attractiveness of long term investments in innovative companies. Furthermore, there is a risk that the integrity of the Listing Committee could be scrutinised if a consistent approach is not taken.

Therefore, we request:

- *Greater transparency on decision-making*

The HKEX should provide some transparency around the decision making process of the Listing Committee to accept/reject the application of companies under this profiling. This will help investors understand why companies are being accepted or turned away from listing in the Hong Kong market.

- *Explanation of skills/experience of Listing Committee Members*

The Listing Committee should demonstrate to the financial markets that it has the competence and ability to appropriately assess companies and their business models in profiling them as innovative companies. The Listing Committee should clarify to the market what evidence and disclosures it has examined, advice received and debates undertaken by committee members to make the final decision.

## 2) Two-tier voting regime in Hong Kong

LGIM believes that voting rights are a fundamental characteristic of equity capital. It underpins effective investor stewardship, and is the central mechanism through which shareholders exercise their ownership rights.

We welcome certain measures proposed by the HKEX to mitigate expropriation and entrenchment risks such as requiring certain resolutions to be decided on a one-share one-vote basis and requiring safeguards to be included in constitutional documents.

However, the issue of controlled companies is still an important issue to consider for investors in the Hong Kong market. Therefore, in our submission to the HKEX on the 15th December 2017, we recommended that in order to provide more transparency of the nomination and appointment of INEDs for companies with a controlling shareholder we would like to see a dual voting regime (similar to the UK) being explored.

The dual voting process occurs when there is a clear mismatch between the vote cast by controlling shareholders and that of minority investors on the appointment of independent non-executive directors. We believe that Hong Kong will also benefit with a similar mechanism as it will provide more transparency on the views of independent minority investors in controlled companies. This process also promotes good stewardship and we have seen improved greater communication and engagement between controlled company boards and minority shareholders.

We expect an independent non-executive director who does not receive the majority support from the minority shareholders or the controlling shareholder to step down from their position on the board. Additionally, we expect the controlling shareholder, the board of directors and minority shareholders to work together to develop a board structure in the interests of all shareholders.

Therefore, across the whole of the Hong Kong market, we request that the two-tier voting regime is implemented.

## 3) Time-based sunset provision

A sunset provision ensures that within a set period of time post listing, the capital structure of a company reverts back to a single share class with equal voting rights. Requiring economic

interest and control to be aligned in the long-term will facilitate the functioning of the Hong Kong market. Furthermore, we believe that the sunset provisions should be sufficiently long to allow the company to develop and mature, whilst not being prohibitive to effect change.

LGIM has been clear and consistent when communicating to different regulators and index providers globally on this principle. In order for investors to have enough time to review all relevant information, and consider the associated risks, to form an investment case, we request that a sunset provision of 3 to 5 years is implemented.

#### 4) Enhanced Corporate Governance framework for issuers with WVR

The additional strengthening of the corporate governance framework for issuers with WVR is welcomed by LGIM. We support the proposals but believe certain elements of the governance framework can be further strengthened to be more effective. These are outlined below:

- *Development of a whistleblowing mechanism*

We encourage a mechanism being developed to allow for the reporting of concerns where the WVR beneficiaries are seen to be not acting in the interest of all shareholders. This would provide a formal channel for those who are concerned that engagement through the normal process with the board would be ineffective and not lead to appropriate actions taking place.

Furthermore, an external whistleblowing mechanism would strengthen the application of the current corporate governance proposals as companies would not want to run the reputational risk of being investigated for falsely misleading minority investors.

- *Non-boiler plate transparency*

We welcome the requirement of reporting by the Corporate Governance Committee to update the market on its compliance with the Rules.

The HKEX should ensure that company specific content and detail is reported otherwise the disclosure would be meaningless to investors. Boiler plate language should also be avoided as investors need good transparency to assess how companies are addressing risks with WVRs.

- *Role of the Lead Independent Director (LID)*

In our submission to the HKEX, we highlighted the importance of counteracting the balance of power in the boardroom where a combined chair and CEO exists.

We recommended the appointment of a lead independent director on the Board. The role of the LID facilitates the communication of independent directors as a whole and also acts as an important conduit for shareholders to discuss any relevant issues where the board chair may be conflicted.

We propose the LID role is promoted within the Corporate Governance Code for all companies including issuers with WVR. This places greater emphasis on the voice of independent directors in the boardroom and strengthens their role. The US has a similar structure and we believe this is in line with best practice.

- *External auditor rotation*

Shareholders place considerable weight on the assurance provided by an independent and high quality external audit. We note that the appointment and removal of auditors is also included as one of the key matters to be decided on a one-share one-vote basis. This demonstrates that the HKEX also places significant importance on the role of auditors.

Whilst the current Hong Kong Corporate Governance Code discusses rotation for audit partners and staff, it does not mention the rotation and tenure of the external auditor.

LGIM expect companies to review the external auditor at regular intervals and periodically rotate the firm. This provides a number of advantages, in stimulating the audit market, emphasises that the audit is an asset for shareholders, and ensures key judgements are challenged and reviewed on a regular basis.

In line with our submission to HKEX on the Corporate Governance Code, we encourage consideration of an inclusion within the Code to encourage regular re-tendering of the external auditor. LGIM expects, at a minimum, the external auditor to be re-tendered at least every ten years, and a company should change its auditor every twenty years. This occurs in Europe which is in line with best practice.