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Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
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By email to: response@hkex.com.hk

23 March 2018

Re: Emerging and Innovative Companies CP

Dear Sirs,

We welcome the opportunity to comment on the Hong Kong Exchanges and Clearing Limited's (HKEx) Consultation Paper, "A Listing Regime for Companies from Emerging and Innovative Sectors." In conformity with the consultation's guidance, we provide our comments below under separate headings.

BMO Global Asset Management (BMO GAM) is an investment management firm whose institutional and retail clients collectively represent over $250 billion of assets. In addition, our BMO GAM (EMEA) unit has been mandated to vote and/or engage in dialogue on behalf of a further 32 investment institutions with assets, including equities and corporate bonds, totalling over $136 billion (as at 31 December 2017).

We make reference in our response to the letters sent to you by the Asian Corporate Governance Association (ACGA) dated March 23, 2018, the International Corporate Governance Network (ICGN) dated March 22, 2018 and the Council of Institutional Investors (CII) dated 21 March 2018, all in response to this consultation. We fully support these submissions and their recommendations, but would like to make some additional comments.

Issuers with Weighted Voting Rights (WVR) structures

As a global investor, we fundamentally support the principle of "one share one vote" that is premised on a like-for-like match between voting rights and shareholder economic interest in the company. We believe that differential voting rights can lead to market distortions and allows those without a corresponding economic stake to exert undue control and influence over companies. We appreciate that company founders may promote stability in the short-term and as such, the ability to exercise a degree of managerial freedom may be appropriate. However, this does not guarantee that new management or, even existing management, as companies evolve, will be able to create shareholder value and account for developing risks in the long-term.

We see some merit in the safeguards being proposed to provide a system of checks and balances on the WVR listing process. However, we consider them to be potentially ineffective as they can still lead to substantial long-term agency challenges and impose significant new discretionary burdens for the HKEX's Listing Committee.

- **Suitability**: We are concerned about the implementation risks from relying on Guidance Letters to provide the framework for judging the factors that HKEx will consider when assessing the suitability of an applicant to the WVR structure. We find the definition of "emerging" and "innovative" companies to be problematic as it can be subject to wide interpretation, particularly over time as companies in dynamic industries evolve. Furthermore, the reliance on suitability judgements is at odds with the governance and current rules-based approach of the Listing Committee.
- **Ringfencing**: We would like to raise our concerns that spin-offs will be permitted to list with a WVR structure. This will allow for outflow from one-share, one-vote companies to WVR structures.
- **Beneficiaries**: we believe there to be a simpler and more objective approach than the one proposed in the Consultation Paper approach to address some of the heightened long-term agency risks from a WVR structure for minority investors. The potential advantages of dual-class structures tend to recede, and the potential costs tend to rise, as time passes from the IPO. Furthermore, we think controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time. Therefore, we strongly suggest that the governing documents of companies applying for listing under a WVR structure include an explicit, time-defined sunset provision. Under such provision, share classes with enhanced rights would convert into the other class after a specified time from the date of the initial public offering. A number of studies in the US show that firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions seven (7) or more years out from their IPOs. We would, therefore, recommend setting sunset provisions that are at least 7 years long.
- **Limits on WVR powers**: We request the HKEx consider lowering the proposed ratio that WVR shares carry no more than 10 times the voting rights of non-WVR shares.
- **Protecting non-WVR shareholders' right to vote:**
    - The proposed requirement that non-WVR shareholders be able to cast at least 10% of the votes eligible can be potentially meaningless – their votes would hardly have any impact on the final outcome. We request this threshold be increased, at least to 25%.

- We request proposals regarding related-party transactions that involve entities associated with the WVR holder be included in the list of key matters identified in paragraph 28 of the Consultation Paper to be voted by shareholders on a one-share one-vote basis, with the WVR holder excluded from participating in such vote.

As a final note, we would like to highlight our support for the numerous and significant positive contributions to good corporate governance the HKEx has made over the years. Through these, Hong Kong has come to been regarded as a trailblazer among Asian markets. We are concerned that reduction of governance standards by introducing WVR structures, including for secondary listings, may not only impact investor perceptions negatively but also have broader market impacts on companies listed on the Exchange.

Thank you for considering our views. If you have any questions or need additional information on this matter, please do not hesitate to contact me at [redacted] or [redacted]

Yours sincerely,

[redacted]

Juan Salazar
Vice President, Analyst
Governance and Sustainable Investment