



ICGN

International Corporate Governance Network

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

Via Email: response@hkex.com.hk

30 April 2020

Re: Corporate WVR CP

To the Hong Kong Exchanges and Clearing Limited and the Stock Exchange of Hong Kong Limited:

The International Corporate Governance Network (ICGN) welcomes the opportunity to comment on the Hong Kong Exchanges and Clearing Limited (HKEx) consultation on Corporate weighted voting rights (WVR) that was released in January 2020.

ICGN was founded in 1995 and is an investor-led membership organisation of more than 800 individuals based in over 50 countries from around the world. Our mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide. ICGN's members represent institutional investors with global assets under management in excess of US\$54 trillion, and many of our members have significant investment holdings in the Hong Kong market. For more information on the ICGN, please visit www.icgn.org.

Reflecting the importance of Hong Kong as a leading global financial centre, ICGN has responded to past consultations by both HKEx and the Securities and Futures Commission (SFC) relating to corporate governance and investor stewardship. We have been encouraged by many positive developments in Hong Kong, such as the introduction of Principles of Responsible Ownership in 2016 and the SFC's rejection of dual class shares in 2015.

With regard to WVRs, ICGN responded to the HKEx New Board consultation in August 2017, in which we reasserted ICGN's opposition to the introduction of WVRs in the New Board or the Hong Kong market more generally.¹ We made it clear that WVRs or other dual class structures that insulate companies from market forces are fundamentally flawed in nature, and popular with controlling shareholders, who often enjoy "private" benefits of control that are not shared with other shareholders. ICGN's position on this issue remains unchanged: we believe that any temporary benefits that companies may experience from WVRs tend to be negated over time by entrenchment and expropriation risks, and that the dilution of minority voting rights is ultimately anathema to investor stewardship and good corporate governance. These views are supported by a number of studies featured in a Stanford Business School survey of the research literature on dual class shares which offers the following conclusions:

¹ See ICGN comment letter on the HKEx New Board consultation in August 2017: <https://www.icgn.org/sites/default/files/12.%20ICGN%20Response%20to%20HKEx%20Third%20Board%20Consultation%20August%202017.pdf>

- The evidence on dual-class shares tends to be negative.
- In general, dual-class shares are associated with lower firm value, worse capital allocation decisions, and lower governance quality.
- Researchers generally conclude that these outcomes are the result of a controlling share structure that insulates managers from market forces.²

With regard to the current consultation we offer the following specific comments:

- We note the frequent reference throughout the consultation to the business “ecosystem” for innovative companies. We have no objections to the use of this term, but we do not see how reference to this ecosystem is relevant to, or justifies, an argument to introduce WVRs given all of their downside risks. There is a missing piece of logic, or at least that point was not clearly or convincingly made. Moreover, an ecosystem can be supported in ways that need not involve WVRs. Indeed, given the potential conflicts of interest between a listed company and other companies in the ecosystem, we see the potential for this to exacerbate governance risks by controlling owners in the ecosystem, possibly through related party transactions or other private benefits of control.
- Instead of an ecosystem, perhaps an alternative conceptual framework would be to think in terms of the life cycle of the company, in which differing stages of a company’s existence may justify differing governance structures. ICGN does recognise that in an early stage of a company’s existence short term financial market pressures can be challenging, particularly for companies in new and dynamic industries. While ICGN does not believe this justifies WVRs or other form of differential ownership, we do appreciate that the use of sunset clauses is a compromise position that would at least limit the duration, and hopefully the negative impact, of dual class structures. While it is our strong preference not to introduce WVRs at all in Hong Kong, if this is to occur it is appropriate that sunset clauses would accompany WVR structures.
- However, we do have issues with the specific sunset clause structure presented. First, we think ten years is too long, and we can cite research suggesting that seven years is a more appropriate cut off period.³ Second, and more importantly, we believe the structure is flawed by offering the possibility of incremental five year extensions. This is a real weakness to the proposal, and we believe this could lead to abuse, even if left to independent voters to decide. We would strongly encourage a “hard stop” rather than the possibility for ongoing extensions.
- We also believe that the eligibility criteria for the adoption of corporate WVR, while detailed, are ultimately difficult to interpret in terms the nature of the relationship

² David F. Larker and Brian Tayan, “Dual Class Shares: Research Spotlight” Corporate Governance Research Initiative, Stanford Graduate School of Business, 2018: <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-research-spotlight-13-dual-class-shares.pdf>

³ Robert Jackson, “Perpetual Dual-Class Stock: The Case Against Corporate Royalty”, February 2018: <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty>

required between the issuing entity and other ecosystem companies – or at least the criteria seem to introduce an element of subjectivity that may not always be appropriate or clear to investors.

ICGN recognises that other markets apart from Hong Kong have established, or may be considering, differing forms of differential ownership, and that offering dual class listings has become a competitive bargaining chip for stock exchanges to expand their issuer base—even though investors generally disfavour dual class shares.⁴ We are concerned, however, that HKEx is bowing to competitive pressures to contribute to a “a race to the bottom” with other exchanges around the world. We also note the HKEx’s conflict of interest as a listed company with its own proprietary profit motivations.

Our fear is that the highly competitive nature of the global market for new listings and IPOs runs the risk of compromising quality standards in the leading stock exchanges — and puts at a disadvantage the interests of minority shareholders and their beneficiaries, which include retail savers and pensioners. We also have the concern that this development will set a bad precedent and encourage even more stock exchanges in Asia and other jurisdictions globally to take similar initiatives as a way of remaining competitive.

We support innovation by stock exchanges, and believe it is healthy for exchanges to attract new companies to public equity markets. At the same time we encourage HKEx and other global stock exchanges to compete more on the “race to the top” of building quality and trust — and to avoid watering down governance standards for short-term listing benefits.

Finally, we would also like to commend the letter written by the ACGA to this consultation (as they have shared with us a draft of this letter). ICGN and ACGA make similar points relating to the “ecosystem” concept and sunset clauses. But we would also like to voice our support the ACGA letter relating to corporate versus personal WVRs, qualifying exchanges and enhanced minority rights.

Should you wish to discuss our comments further, please contact [REDACTED].

Yours faithfully,

[REDACTED]

ICGN contacts:

[REDACTED]

⁴ In 2017, in an ICGN membership poll, 84% of ICGN members disapproved of differential voting right structures and 67% believed that differential voting structures would impact negatively stock valuations.