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By Letter, and e-mail to: [response@hkex.com.hk](mailto:response@hkex.com.hk)

16 August 2017

Dear Sirs,

**Subject: New Board Concept Paper**

We wish to respond to the Stock Exchange of Hong Kong's Concept Paper on the "New Board" issued in June 2017.

Robeco is an asset manager with approximately USD 140 billion of assets under management, with a significant investment in Hong Kong-listed equities. Robeco is also committed to being an active steward of our assets behalf of our clients, and is a signatory of the stewardship and governance codes of the Hong Kong, the Netherlands, the UK, Japan and Taiwan. We are also a member of the Asian Corporate Governance Association.

**Summary of major points**

We do not support the case for a New Board as we consider that this will increase the risks of further market fragmentation, and that the provisions for companies with weighted voting rights (WVRs) are unsuitable for the Hong Kong market as investors lack the regulatory protection and legal remedies available in other markets.

Overall, the Concept Paper places far too much emphasis on the benefits on IPO issuer diversity and increased turnover, which benefits only a certain group of market participants, while insufficiently addressing more strategic, long-term issues for investor stakeholders, including the promotion of long-termism and the further development of Hong Kong as a high quality listing venue.

**The need for a new Board**

We do not support the case for a New Board as we consider that this will increase the risks of further market fragmentation, and that the provisions for companies with "non-standard governance features" (in particular weighted voting rights/WVRs) are unsuitable for the Hong Kong market as investors lack the regulatory protection and legal remedies available in other markets.

While we agree that the Hong Kong market and economy would benefit from attracting a more diverse range of companies, we do not believe that the lack of access to a more diverse range of companies (notably New Economy companies) or the inability to allow dual-class (or shares with Weighted Voting Rights) are major barriers to the development of Hong Kong as a listing/IPO venue. The US equity markets (especially Nasdaq) are the listing venues of choice for many New Economy companies, and neither a New Board nor WVRs will change that. In particular, we believe that the HKEX should address more strategic issues such as improving market quality over issues such as issuer diversity and trading volumes via IPOs.

The Concept Paper remarks that Hong Kong has “minimal weightings” in the fast-growing industries globally, and immediately follows that point with an observation that Hong Kong’s valuation is almost half compared to its peer group average, thereby implying that a market merely needs to have fast-growing companies to achieve higher valuations. We wish to refute this common mis-perception. Empirical research which examined whether countries with higher long-run real GDP growth also had higher long-run real stock market return found surprising results contrary to expectations -- the correlation between stock returns and economic growth across countries can be negative!<sup>i</sup>

Some of the fast-growing industries referred to are in industries like Pharmaceuticals and Software which consist of companies owning globally-competitive intellectual property developed by a highly-trained, diverse workforce. Furthermore, other reasons for Hong Kong companies’ low valuation may be due to factors un-related to growth, including poor capital allocation, governance and other quality issues. We believe that these desirable public policy objectives can be better addressed by developing local intellectual property with educational opportunities and productivity improvements, and by policy measures to encourage a long-term investment mindset and engaged investors among the investment community. Therefore, in order to attract fast-growing companies, government policy should also “build the software, not just the hardware.”

### **Detailed Regulatory Considerations**

Given our stated positions above, we do not wish to convey an impression that our remarks on some of the proposed regulatory considerations sought below are to be considered a tacit support of the key proposals of a New Board and for dual-class shares.

### **Admission Criteria (page 32)**

Companies listed on a Recognised (US) Exchange should NOT be exempted to demonstrate that they are subject to shareholder protection standards equivalent to Hong Kong. Several “recognised” Exchanges have notably weaker investor protection standards and rely extensively on enhanced disclosure, but those Exchanges also have either more legal remedies for investors (e.g. class-action suits in the United States), and/or highly-engaged and active local institutional investors (notably the US, UK and Australia). These features are largely absent in Hong Kong. Companies that are already listed on the GEM/Main Board should NOT be allowed to either move to the New Board, nor be allowed to inject a material part of their existing business into a shell on the New Board.



**Requirements for WVR (dual-class) companies (page 35)**

We reiterate our objection to the listing of WVR companies, as institutional investors have long supported the “proportionality principle”: the voting right associated with an equity interest in a listed company must be proportional to the capital contribution. It is possible to deviate from this principle by using different classes of share, for example loyalty shares or preference shares.

While considering conditions that may be appropriate for different jurisdictions, Robeco’s current position is aligned with that of Eumedion, an association of Dutch institutional investors: -

- We advise that no more than one temporary protective structure is permitted. Permanent forms of protection, such as granting extra voting rights and/or shares to founders/major shareholders or introducing shares with high and low voting rights (dual-class shares), are not appropriate.
- In the event that a listed company nevertheless wishes to introduce a structure with permanent effect, we believe that the company should always put such a separate resolution to a shareholders vote.
- Safeguards: Although we remain opposed in principle to the admission of dual-class shares in Hong Kong, we refer you to some of the safeguards proposed in Singapore Exchange’s Consultation Paper against Entrenchment Risks and Expropriation Risks. Other jurisdictions which permit listing of dual-class shares adopt similar safeguards to mitigate entrenchment risks. In addition to the two safeguards above, we also support a proposal by Baker & McKenzie to address the risks that investors may not have sufficient knowledge of the risks associated with the dual-class shares by adopting further safeguards, including increasing investor awareness of shareholder rights by:
  - Companies with dual-class share structures to provide clear disclosure of shareholder rights.
  - Clear Identification of securities of companies with a dual-class share structure.
  - Investor education initiatives.

**Conclusions and Recommendations**

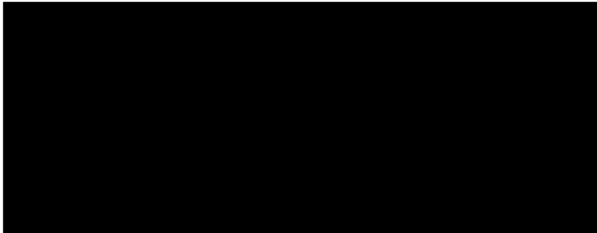
We do not support the case for a New Board as that this will increase the risks of further market fragmentation, and that the provisions for companies with “non-standard governance features” are unsuitable for the Hong Kong market as investors lack the regulatory protection and legal remedies available in other markets.

The HKEX should address more strategic issues such as improving market quality over issues such as issuer diversity and trading volumes. Proposals to improving market quality include, but are not limited to the following:

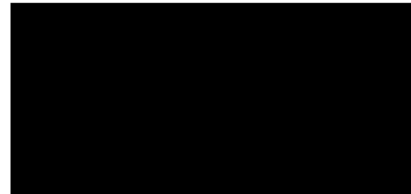
- a) improving the accountability and effectiveness of corporate boards;
- b) increasing corporate reporting of relevant, material non-financial issues, including disclosure comprehensive corporate strategy, and explanations on large unexplained items in the income statements;
- c) encouraging more active stewardship by large, local investors.

We wish to invite the HK Exchange and other stakeholders for a discussion of contents of this feedback in more detail.

Yours sincerely,



Arnout van Rijn  
Chief Investment Officer  
Asia Pacific



Ronnie Lim  
Active Ownership  
Asia Pacific

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<sup>i</sup> Is There a Link Between GDP Growth and Equity Returns? MSCI-Barra Research, May 2010