



Hong Kong Investment Funds Association

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

1002 Tak Shing House, 20 Des Voeux Road Central, Hong Kong

Tel: (852) 2537 9912 Fax: (852) 2877 8827, 2877 2368

Website: <http://www.hkifa.org.hk> E-mail: hkifa@hkifa.org.hk

August 18, 2017

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

Dear Sir/madam,

Re: HKEX New Board Concept Paper

On behalf of the Hong Kong Investment Funds Association (Appendix 1 for the backgrounder), I attach herewith our submission with respect to the captioned Paper.

We would very much look forward to having the opportunity to meet up with your team to share our thoughts and answer any questions that you have. I can be reached on [REDACTED]

Yours sincerely

Sally Wong
Chief Executive Officer

Hong Kong Investment Funds Association

(August 2017, Comments and questions raised by Hong Kong Investment Funds Association in response to the HKEX Concept Paper issued in June 2017)

The Hong Kong Investment Funds Association applauds the HKEX for spearheading the initiative to lead the discussion about how to further develop the Hong Kong stock market to enable investors to capitalize on the investment opportunities as represented by the “new economy” as well as to further reinforce Hong Kong’s leading position as a leading IPO Centre.

With respect to the Proposal, there may be mixed views within the fund management community; but as an Association and purely from the investors’ perspective, we believe that “dual share class” is a proposition that is against the interests of investors.

The principle of “One-share one-vote” accords equal treatment to all shareholders by ensuring that the control of a company is in direct proportion to the economic interest. This ownership structure is an important mechanism to protect the rights and interests of minority shareholders by ensuring that the management of a listed company be accountable to all shareholders.

There are concerns that as more markets – albeit a small number - start to open the doors to dual share class, there could potentially be a global race to the bottom in terms of governance standards.

There are individual managers who believe there is a need to take a hard look at the weighted voting rights (“WVR”) option in order to attract a more diverse range of companies and, in particular, those from the new economy industries to list in Hong Kong given that the lack of such an option has denied investors the ability to assess these investment opportunity sets – this is especially so for retail investors as institutional investors may be able to invest in these companies through other markets. They believe that what is key is for investors to have a choice and for them to understand the difference, what it entails and the associated risks, and to make decisions that commensurate with their risk/return appetite.

Hong Kong Investment Funds Association

In addition, some opine that by refusing to allow dual share class structure, the HKEx is missing out on the new economy, and is stuck in the old economy sectors such as banking and property. Some fund managers point out that increasingly, they and investors in Hong Kong have to work evenings so as to transact in leading companies such as Alibaba, Baidu, Netease and JD.com in New York. Closing the door to such companies would mean that businesses that should have come to Hong Kong would go elsewhere. This would deprive Hong Kong of a key growth driver that all key financial centres are vying for. As pointed out in the Concept Paper, the leakage is substantial. They opine that the New Board PREMIUM, which are targeted at companies that meet the existing financial and track record requirements of the Main Board, but which are currently not eligible to list in Hong Kong because they have non-standard governance structures, should be allowed.

However, on balance, as a principle and purely from the investors' perspective, we are generally concerned that WVR is a negative development in terms of protecting investors as it strips them of an extremely important tool to have sway over the management of a listed company. Fund managers owe a fiduciary duty to their clients or beneficiaries to vote or otherwise engage with investee companies. By voting, shareholders can participate in, inter alia, the selection of the board, voting on proposals re remuneration and effecting changes. But if they are deprived of these rights, the ability to ensure that investor interests are adequately protected is greatly curtailed. This is especially so for cases where listed companies have controlling shareholders; and when there is a misalignment of interest and companies engage in practices that are detrimental to the interest of investors.

It must be remembered that while key investors with significant voting rights may facilitate long-term growth and firm performance, there are well-documented risks that beneficial owners, with a controlling share of voting rights, may also have the incentive to divert corporate assets and exploit opportunities for personal gains.

Some observations and suggestions:

Based on recent press reports, it seems that barring major controversies, the

Hong Kong Investment Funds Association

HKEX would launch the new Boards in the first half of next year. We have concerns that the proposals as outlined in the Concept Paper are already a fait accompli; and the authorities are rushing into this without letting the community know the full ramifications; and investors may not be fully aware of what they are getting into.

1. To enable the community to fully understand the risks that entail with the proposal, in particular WVR, we would strongly exhort the HKEx to issue a Part II to the HKEX Concept Paper to provide a comprehensive picture. The paper should, inter alia, expound on the risks factors; proposed countervailing tools/mechanisms to accord adequate investor protection; as well as limitations of these tools. This would complement the current Concept Paper which has primarily focused on the upside and the potential opportunities; but is short on the downside and how investor interests would be compromised. We believe that only after providing a complete picture can there be a balanced and informed discussion.
2. In view of the inherent asymmetry between the rights of investors and the issuers under the WVR structure, the gatekeeping role is all the more important. If the policy intent is to introduce WVR at all costs, we believe that the regulation of the new Boards should be vested entirely with the SFC. Furthermore, the authorities should take this opportunity to conduct a holistic review of the regulatory framework to see whether the whole approval process (including that for the Main Board) should be vested with the SFC.

Questions we would exhort the HKEX to address with respect to the Concept Paper:

(1) General:

- We would strongly exhort the HKEX to provide answers to the questions that the SFC had raised with the HKEX when it issued the consultation paper in 2014. Similar questions were raised in a recent speech by Mr Alder at the HKSI luncheon. (<http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/CEO%20speech%20at%20HKSI%20final%2013%20Jul.pdf>) P. 9-11. We believe that they are very pertinent and in particular, are we trying to circumvent

Hong Kong Investment Funds Association

the fundamental question of the merits and demerits of Dual share class by adding new Boards instead of facing it upfront? Realistically, can we ring fence the issues/problems just by creating some new Boards?

- It seems that there is an assumption that only if we allow WVR structure will the HKEX be able to attract new economy companies ("NECs"). However, over the years, a not-insignificant number of NECs (including mega size ones) have been listed on the HKEX. If one looks at what's in the pipeline (via the A1 application list), quite a number of them are NECs. Thus, is the assumption valid?

(2) Specific:

Some of the key questions that we believe the HKEX should fully address in Concept Paper II so as to put the discussion into perspective:

- a. Under the PRO and PREMIUM boards, issuers will not be required to provide equivalent shareholder protection standards. So, what does this mean for a Hong Kong-based investor – what rights is he/she giving up so as to avail of the investment opportunities? What are the residual rights that he/she is left with; and what are the tools available to enforce his/her rights? What are the limitations of these tools?
- b. By allowing secondary listings by mainland listed companies, what sort of regulatory handle will the SFC and/or HKEX have over these companies? More importantly, how effective will the SFC and/or HKEX be able to enforce? As mentioned above, what rights are accrued to HK-based investors under this arrangement and what tools can investor avail of?
- c. Under the proposal, it seems that there is an implicit reliance on the US regulatory framework. However, even the US regime – e.g. Foreign Private Issuer regime, has its own constraints, e.g. some companies listed there do not convene an AGM for years, and there is no mechanism to impose an obligation on it. So, firstly, can the HKEX explain to the investors what are the key features of the US regime, what are there to protect HK-based investor interest and more

Hong Kong Investment Funds Association

- importantly, what are not available?
- d. It has always been said that under the US regime, “class action” is an important tool to address the shortcomings of the WVR structure. There has been much discussion about introducing class action into Hong Kong, however, what is the timeline? More importantly, even if class action were to be introduced, one should not see it as a panacea because a key challenge is to have shareholders to initiate these suits. If one consider the culture in Hong Kong, we are not sure whether this will be an effective deterrent. In addition, the procedural and financial hurdles are high.
 - e. In general, under a WVR structure, investors can be partially or completely stripped of the voting power. So, what mechanisms would the HKEX institute to ensure that the board is held accountable to the company and to the shareholders?
 - f. With the high degree of ownership concentration; and the fact that the management and the board are basically appointed by and answerable to one or a few controlling shareholders, would there be a higher bar re “independence” – i.e. independent from both the management and the controlling shareholders (e.g. need to be appointed by minority shareholders)? If one looks at the current regime, board “independence” is already in format rather than substance. We are concerned that this problem will only aggravate under a WVR structure.
 - g. Under a WVR structure, should there be more effective mechanisms for shareholders to obtain effective redress for violation of their rights - for instance, on enforcement and dispute resolution? Should the range of sanctions available for the regulators to deter and punish wrongdoing (e.g. on abusive related party transactions) be broadened? To detect and discipline conflicts of interest, such as related party transactions that are made at the expense of minority shareholders, it is important to have the full picture of ownership and control structures, and persons with de facto controls. Should there be mechanisms to facilitate easier access to information on ownership structure; and in general corporate access?
 - h. There are a number of areas in the Concept Paper that need further clarification, e.g.
 - What does “lighter touch” approach entail (PRO) and what are

Hong Kong Investment Funds Association

more "stringent"? Compared against what?

- The board will be open to "professional investors" – Under the current regulatory regime, in fact, there are two definitions, one is under the Ordinance and the other is applicable if the licensed entities wish to avail of certain waivers under the Rules. So, what is the exact definition of PI under the Concept Paper?
- Definition of "new economy": The Paper cites certain sectors as falling within this category, but what measures will the HKEX adopt to ensure that the definition will not be abused? (e.g. it maybe possible to establish some nexus with these sectors and be used as a guise to get listed on the new Board).
- More generally, if the "new economy" sectors become the "new normal", will we end up in a situation where more and more of these companies will come onto the main stream; and then, how would the new Boards be distinguished from the Main or the GEM Board?
- Will the addition of new Boards result in a fragmentation of liquidity? As the addition of any new Boards is for the long haul, we wish to understand not only the short term plan but also the medium and longer term plan of how this market will evolve. This is not only important for the issuers, but for investors as well because fund managers typically invest for the long-term and they need to examine not only the sustainability of the investee companies, but also how the market on which they are listed will develop as it has systematic implications. We believe that instead of just looking the proposed Boards in silos, the HKEX should provide a holistic picture and explain fully how the new Boards will interact with the existing ones and how it would pan out over the medium and long-term. In conclusion, we wish to have a longer term road map from the HKEX.

(End)

Hong Kong Investment Funds Association

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.

At present, HKIFA has 67 fund management companies as full/overseas members, managing about 1,350 SFC-authorized funds. Assets under management were about US\$1,120 billion as at the end of June 2017. In addition, we have 58 affiliate and associate members.

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

(Updated: August 2017)

