



Hong Kong General Chamber of Commerce
香港總商會1861

香港總商會
香港金鐘道統一中心廿二樓
Hong Kong General Chamber of Commerce
22/F United Centre,
95 Queensway, Hong Kong
Tel (852) 2529 9229
Fax (852) 2527 9843
Email chamber@chamber.org.hk
www.chamber.org.hk

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18 August 2017

Mr C K Chow, GBS, JP
Chairman
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

25 AUG 2017

Dear C K,

New Board Concept Paper
and
Consultation Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules

We are pleased to attach for your consideration our comments in response to the captioned consultation exercises.

The Chamber is supportive of finding ways to attract more companies to list in Hong Kong but feels that, at the same time, this should be balanced against such key considerations as investor protection and corporate governance.

We hope you will find our comments to be useful to your deliberations.

Sincerely

Shirley Yuen
CEO

Encl.

Response to HKEx's consultation papers on (a) the New Board and (b) Review of the Growth Enterprise Market (GEM) and Main Board Listing Rules

Hong Kong General Chamber of Commerce ("HKGCC") welcomes this opportunity to comment on the consultation papers (CPs). Our main comments are directed to the CP on the New Board ("the New Board CP"). This is because we believe that there are serious concerns about the proposal for a new Board (including the need for a new Board itself) that need logically to be addressed and resolved before any rule changes of GEM or the Main Board, or other changes, can be determined. As the CP on the GEM states, "*there are certain interdependencies between the two proposals and...the responses to both papers will need to be considered holistically in the final approach*".¹ What changes (if any) might be made to GEM will logically depend on whether the proposed New Board should be created, and if so what form it should take and what its constitution would be. Hence, we deal with the CPs holistically in our response.

We note that the New Board CP proposes that the New Board comprises two "segments": "New Board PRO" and "New Board Premium". Under both, weighted voting rights ("WVR") would be permitted whereby certain shareholders would have voting rights which are disproportionately higher in relation to the value of the equity they have invested. This proposal is hard to understand, for the following reasons:

- WVR is a departure from Hong Kong's traditional "one share, one vote" arrangement, a bedrock principle of good corporate governance.
- The New Board CP itself recognizes that there are "*entrenchment and expropriation risks associated with WVR structures*".² These risks include WVR shareholders/directors being able to block takeover proposals which might be beneficial to the company, no matter how poorly they perform, and the incentive (according to empirical evidence) to extract benefits from the companies from themselves at the expense of other shareholders.
- Hong Kong has been ranked third in the world for investor protection, ahead of the US in sixth place. Many believe that this high ranking is a source of competitive advantage in attracting investment and listings.
- Hong Kong has already been consistently ranked as the top IPO centre in the world.
- The New Board CP itself identifies factors which have enhanced Hong Kong's success as an international finance centre (whether in spite of, or perhaps even because of, the lack of WVR structures), such as the rule of law, simple and transparent tax system, large network of professionals, and so on.³
- The SFC has opposed, or at least expressed extreme scepticism about, WVR, primarily given the risks to investors.⁴

The proposal is all the more perplexing because HKEx itself relatively recently conducted a public consultation exercise specifically on the issue of whether WVR should be introduced in Hong Kong. The WVR Consultation Paper (WVR CP) stated that: "*the fair and equal treatment of shareholders is a general principle of the Listing Rules to which the Exchange pays particular regard when considering the suitability of new applicants for listing ... It has, for many years, been seen as an important aspect of investor protection in Hong Kong, in the sense that it helps align controlling shareholders' interests with those of other shareholders and makes it possible for incumbent managers to be removed, if they under-perform, by those with the greatest interest in the company*".⁵

¹ Para 9.

² Para 103.

³ Para 21.

⁴ "SFC Statement on the SEHK's draft proposal on weighted voting rights" 25 June 2015.

⁵ HKEx "Concept Paper: Weighted Voting Rights" August 2014 paras 5,6.

The Consultation Conclusions observed that: “it is clear from the responses that this remains a subject on which there are strong and divided views”.⁶ The WVR CP said that it envisaged that the outcome of the consultation exercise would be either no change to the existing practice of not permitting WVR structures, or support for a change: in either case HKEx would publish reasons for its conclusions.⁷ However the Consultation Conclusions did not do so. On whether WVR structures should be allowed, it merely stated that the risks that such structures were perceived to bring could be mitigated by putting measures in place to mitigate the risks. There was no attempt to quantify those risks, to evaluate the benefits that WVR was perceived to bring to Hong Kong, or to weigh the risks and costs against the perceived benefits.⁸ In other words, no regulatory impact assessment (RIA) of such a major proposed change of practice was made, or at least published. Nor is any such RIA contained in the New Board CP.

To be clear, we do not object to HKEx’s efforts to compete with overseas exchanges in attracting listings. However, this must not be done at the cost of reducing investor protection. Indeed, this is a requirement imposed on HKEx by the Securities and Futures Ordinance (“SFO”).⁹ There must be clear evidence that WVR structures (whatever form they may take) pose no risk to the investing public before they are introduced, and that the safeguards against such risks will be effective. So far, no such evidence has been produced. In particular, it is not clear how the safeguards suggested in the New Board CP would eliminate the expropriation risks of WVR that it identifies (see paragraph 2, second bullet point, above). We also note that in Singapore major concerns have been expressed recently about the introduction of WVR.¹⁰

In conclusion, a major and controversial change of policy such as the introduction of WVR requires a proper cost-benefit analysis, in the shape of a regulatory impact assessment, showing that the benefits of introducing WVR to Hong Kong clearly exceed the costs and risks, before it should be implemented.

As the introduction of WVR is a central part of the proposal for a New Board, we believe that the issue of WVR must be resolved first before serious consideration is then given to that of the New Board. For that reason, and because the two CPs are interdependent (as HKEx has recognized), any further work on the CPs should be deferred until the WVR issue is properly resolved.

⁶ Para 4.

⁷ WVR CP para 51.

⁸ Note 5 above paras 102-103.

⁹ SFO section 63(2).

¹⁰ <https://www.dealstreetasia.com/stories/fund-managers-oppose-dual-class-shares-plan-in-singapore-70238/>