



California State Teachers'
Retirement System
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August 17, 2017

Hong Kong Exchanges and Clearing Limited via email: response@hkex.com.hk
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Re: 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

I am writing on behalf of the California State Teachers' Retirement System (CalSTRS) in response to your two market consultation requests – (1) on the proposed New Board on the Hong Kong Exchange (HKEX) and (2) on the Review of the Growth Enterprise Market (GEM) with changes to GEM and Main Board Listing Rules. Thank you for the opportunity to respond to these two consultations. CalSTRS' appreciates HKEX's revitalized mission to strengthen its reliability as well as innovate for the future by offering creative, efficient solutions, as a global exchange in the market.

CalSTRS is the largest educator only pension fund in the world, with a global investment portfolio valued at approximately \$213.5 billion as of July 31, 2017.¹ CalSTRS' mission is to secure the financial future and sustain the trust of California's educators. We serve the investment and retirement interests of approximately 914,000 plan participants and their beneficiaries. The long-term nature of CalSTRS liabilities, the composition of its portfolio and the Teachers Retirement Board's fiduciary responsibility to its members, make the fund keenly interested in the rules and regulations that govern the stock market exchanges. CalSTRS has a vested interest in ensuring shareholder protections are safeguarded as we rely upon the integrity, stability and efficiency of the capital markets to pay out benefits to CalSTRS' beneficiaries. CalSTRS has a commitment to healthy public markets and strong corporate governance. As of June 30, 2017 CalSTRS held approximately 1.8 billion shares of companies listed on the Hong Kong Stock Exchange at a USD market value of approximately \$3.2 billion.²

After reviewing the concept paper for the New Board we are concerned that the HKEX's focal point seems to be on measures solely intended to attract the Initial Public Offerings rather than the range of global market fundamentals which would improve Hong Kong's ability to continue

¹ CalSTRS Current Investment Portfolio for the period ending July 31, 2017.
<http://www.calstrs.com/current-investment-portfolio>

² FactSet CalSTRS Global Exchanges holdings report, July 31, 2017.

as a global financial center. CalSTRS is concerned with the proposed “straw man” Stock Exchange of Hong Kong Limited (SEHK) concept to introduce a new listing venue to accommodate companies that do not meet the more rigorous listing standards of HKEX by including companies with “non-standard” governance features. CalSTRS believes that strong corporate governance serves as a foundation for strengthening investor protections in our pursuit to achieve long-term sustainable investment returns. All companies should incorporate strong corporate governance practices.

We understand the purpose of the New Board PREMIUM would be to target companies that would qualify for listing on the Main Board but are ineligible due to non-standard governance structures, namely companies with weighted voting rights (WVR) (also known as Dual Class Shares(DCS)). WVR allow certain shares to have higher voting rights than others. CalSTRS does not support creating a WVR share structure. As a long-term shareholder, CalSTRS supports the principle of one-share, one-vote.

As a member of the Council of Institutional Investors (CII), we agree with CII’s letter to the HKEX stating that the “proposal put forward in this concept paper is narrowly focused on attracting listings in the near-term, and it appears to us that insignificant consideration has been given to the impact that the proposal could have on company performance and investors in the longer-term.” We also agree with CII that “it is a mistake for HKEX to follow other exchanges, including those based in the United States, in a competition to offer reduced standards around public listings, whether through dilution of Main Board and GEM standards or through creation of a new, low-standard board.”³

CalSTRS believes equal voting and control rights proportional to economic interest represents best governance practice. We believe a structure that sustains “one-share one-vote” equally aligns shareowners’ economic interests. CalSTRS believes a WVR structure disenfranchises the majority of equity holders as it allows WVR owners the ability to control more voting rights without having to risk an equal amount of capital. CalSTRS Corporate Governance Principles outlines our Board’s support to the one-share, one-vote principle.⁴ We also believe “one share, one vote” structure is associated with stronger long-term performance and mechanisms for accountability to owners.⁵ We recommend the HKEX preserve its current listing standard supporting equal voting rights for each share.

³ CII letter to Hong Kong Exchange on New Board concept paper, August 4, 2017
http://www.cii.org/files/issues_and_advocacy/correspondence/8-4-17%20CII%20response%20to%20HK%20Concept%20Paper.pdf

⁴ California State Teachers’ Retirement System, Corporate Governance Principles, 4. Other Governance Matters, Section d. Unequal Voting Rights, page 15, Updated July 14, 2016. http://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf

⁵ Council of Institutional Investors (CII) sign-on letter by CalSTRS and shareholders with combined assets under management exceeding \$3 trillion to the CEO, Chief Technology Officer, Chairman- Designate of Snap, Inc.

CalSTRS concludes that companies adopting a WVR structure are sending a message to their shareholders that they want to control a majority of the votes without taking the majority of the risk. Matt Orsagh from the Chartered Financial Analyst (CFA) Institute provided a discerning comment with regards to Dual Class Shares/Weighted Voting Rights:

Another way to say it is that companies (with DCS/WVR) want the public's capital, just not their opinions. If issuers don't want to give up control of the company they can finance through debt, raise venture or equity capital, sell fewer shares so they retain control, or they can simply choose to remain a private company.⁶

Furthermore, the allowance of WVR goes against HKEX's own 2015 findings of the risks associated with WVR and the decision to forgo the potential implementation before even reaching the consultation stage.⁷

As a member of the Asian Corporate Governance Association (ACGA), we also agree with ACGA's letter to the HKEX stating that the "over-reliance on the listing lens ignores decades of relevant research and market experience establishing the importance of broad-based market governance to positive outcomes for both investors and issuers." CalSTRS also agrees that "segmentation distracts from and degrades Hong Kong's core value proposition as a mature and increasingly sophisticated market. Also the growth of the Main Board is an endorsement of Hong Kong's vital role as the international market for Chinese enterprises capable of meeting higher governance standards."⁸

CalSTRS believes that WVR structures may exacerbate governance risks by distorting the relationship between ownership and control. CalSTRS is a strong advocate of investment stewardship and corporate governance principles. As a long-term institutional investor we take our fiduciary responsibility seriously in our proxy voting and engagement guidelines of portfolio companies.⁹ CalSTRS respectfully urges the HKEX to take this opportunity to maintain the best interests of investors by preserving the one share, one vote listing standard at the Hong Kong

⁶ Matt Orsagh, CFA, CIPM, CFA Institute, *Dual-Class Shares: From Google to Alibaba, Is It a Troubling Trend for Investors*, 1 April 2014. <https://blogs.cfainstitute.org/marketintegrity/2014/04/01/dual-class-shares-from-google-to-alibaba-is-it-a-troubling-trend-for-investors/>

⁷ *Hong Kong exchange gives up on dual-class share plan*, Financial Times, October 5, 2015. <https://www.ft.com/content/0bc597ee-6b42-11e5-aca9-d87542bf8673>

⁸ Asian Corporate Governance Association response to HKEX consultation, August 14, 2017. http://www.acga-asia.org/upload/files/advocacy/ACGA%20Letter%20on%20HKEX%20New%20Market%20Concept%20Paper_Final2%20August%2014%202017.pdf

⁹ Investor Stewardship Group and the Framework for U.S. Stewardship and Governance, CalSTRS founding member with 15 additional U.S. and international institutional investors, 2017. <https://www.isgframework.org/>

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Stock Exchange. We don't believe the proposed "straw man"; New Board is in alignment with the HKEX's revitalized mission and image.

Additionally, CalSTRS supports HKEX's proposal to eliminate the GEM streamlining process to the Main Board and the increase in the post-IPO lock up period for controlling shareholders given the issues outlines in HKEX's Consultation Paper.

Thank you again for soliciting comments and for the opportunity to respond. If you have any questions or would like to discuss this letter further, please do not hesitate to contact me at [REDACTED], [REDACTED] or Mary Hartman Morris, Investment Officer at [REDACTED], [REDACTED].

Sincerely,

[REDACTED]

Anne Sheehan
Director of Corporate Governance
California State Teachers' Retirement System

Cc: Brian Rice, Portfolio Manager
Douglas Chen, Investment Officer