<u>Submitted via Qualtrics</u>

Company/Organisation view

<u>Question 1</u>

Do you agree with the proposal to amend the Listing Rules to remove the requirement to cancel repurchased shares?

No

Please provide reasons for your views.

• While we appreciate the Exchange's intention to modernize Hong Kong's market infrastructure by aligning its regulations on share buyback and treasury shares with other markets, as a fiduciary of our clients investing in the Hong Kong market, we consider the current requirement on companies to cancel repurchased shares a merit instead of a deficit.

• With the Exchange's proposal to require a resale of treasury shares to be subject to the same requirements as an issuance of new shares, we understand that the primary impact of the proposal would be to allow listed issuers to resell their treasury shares directly on the Exchange, without increasing the maximum dilution permitted under the current Listing Rules. Although this would provide more flexibility to issuers in terms of capital management, we are concerned that the proposal could lead to three unintended consequences.

• Firstly, the proposal may weaken share buybacks as a way to return capital to shareholders. Investors consider that the primary function of share buybacks is to return cash to shareholders, and to do so, repurchased shares need to be cancelled to signal to the market that an issuer does not expect to raise capital in the market in the foreseeable future. When repurchased shares are not cancelled but can be readily resold on the Exchange, from our experience in some other markets, investors typically expect these treasury shares to return to the market. Accordingly, they do not exclude treasury shares from earnings per share (EPS) calculations in their modelling, in contrast to the accounting treatment. Therefore, the market may stop reacting favourably to share buybacks which are not cancelled but held in the form of treasury shares under the proposed regime, as the share buyback's function as a shareholder return mechanism weakens. From a capital management perspective, the cash spent on share buybacks without cancellation is essentially no different from idle cash sitting on companies' balance sheets without creating value for shareholders. Put another way, from an investor's standpoint, if a company has additional cash, it should either reinvest that cash in its business or return it to shareholders through dividends or by repurchasing and cancelling them. If however a company repurchases shares but does not cancel them, this complicates an investor's assessment of the repurchase action. It is also important to consider market context and in our view having a treasury shares regime is more likely to be considered by investors as a negative in markets where capital allocation is generally not efficient enough to build investors' confidence.

Notably, under Proposal (4)(b), treasury shares would be excluded from the calculation of an issuer's market capitalization. If, as suggested above the market stops reacting favourably to share buybacks, this lack of share price reaction could potentially lead to shrinking market capitalization if a company continues to repurchase its shares without cancellation. If the market turnover ratio remains constant, shrinking overall market capitalization would result in lower trading volume on the Exchange.

• Secondly, the proposal may encourage imprudent capital management. Allowing the resale of treasury shares on the Exchange, together with share repurchases, would enable companies to trade their own shares on the Exchange in both directions. We agree with the Exchange that companies should not repeatedly repurchase and resell their own shares on the Exchange to make a trading profit, but we consider that the proposed 30-day moratorium period is too short to deter companies from doing so. A parallel that can be drawn is the reissuance mandate that allows a company to repurchase shares and then re-issue them within a year – we generally do not consider this to be prudent capital management and would vote against such proposals. By the same token, a 30-day moratorium under the proposal seems insufficient for trading a company's own shares on the Exchange. Please also refer to our responses to Questions 3, 4 and 5.

• Thirdly, in relation to the second point, allowing companies to trade their own shares would heighten the risks of insider trading. A company's management is a company insider and hence is highly likely to have information advantages over investors in the market. While we appreciate the Exchange is introducing a one-month restricted period preceding results announcements, we are concerned about information asymmetry when most Hong Kong issuers only report financial results twice a year. When a company can trade its own shares in the subsequent five months following its results announcement, there is plenty of time for insider information to accumulate. Although the proposed restricted period is in alignment with the current regulation on share buybacks, we believe stricter regulation is warranted for the resale of treasury shares given the potential negative impact on share price. For further details and potential negative impact on market liquidity, please refer to our response to Question 6.

• If the Exchange is to proceed with the proposal to remove the requirement to cancel repurchased shares, we suggest the Exchange strengthen its proposed safeguards to address the above risks, which we will discuss further in relation to other consultation questions. We also suggest the Exchange introduce a 10% maximum limit on the treasury shares a company can hold to address the issue of market overhang, which has been consistently observed in other markets such as the United Kingdom, Singapore, and mainland China. A sunset mechanism to cancel any treasury shares three years after repurchase, as observed in mainland China, would also help address the issue.

• The consultation paper suggests that requiring a resale of treasury shares to be subject to the same requirements as an issuance of new shares, including general mandate limits, would address the issue of market overhang. It should be noted, however, that under the current regime a general mandate allows companies to issue up to 20% of its total issued shares (30% if combined with reissuance mandate) within a year at up to 20% discount to market price. Where companies have sought to obtain such general mandates from shareholders, we have typically been voting against such proposals as we view that such flexibility is excessive and do not believe these limits meaningfully mitigate concerns about market overhang. Under the proposed treasury shares regime, when companies can resell treasury shares on the Exchange directly, which we consider to be more convenient and flexible than new share issuance, the dilution risks posed by market overhang, and permitted by a general mandate, are higher than those from off-market share issuance, even though the maximum number of shares a company can issue under its general mandate has not changed. We therefore strongly encourage the Exchange to revisit the regulation on general and reissuance mandates and consider reducing the each of the maximum dilution and maximum discount of the general mandate to 10% and removing the reissuance mandate altogether. As an immediate possible step, a 5% sub-limit on on-market resale of treasury shares under the general mandate framework could help mitigate concerns about market overhang, in recognition of the significant difference between on-market reissuance and new share issuance.

<u>Question 2</u>

Do you agree with the proposal to require a resale of treasury shares to be subject to the same requirements as an issue of new shares as described in Proposal (1)(a) to (c) above?

Yes

Please provide reasons for your views.

• If the Exchange is to proceed with the proposal, it is critically important that a resale of treasury shares is subject to the same requirements as an issuance of new shares. This will limit the impact of the proposal to allowing a resale of treasury shares on the Exchange, without increasing the maximum potential dilution permitted by regulations nor creating loopholes for related party transactions. This will avoid certain extreme scenarios we have observed in other markets where, for example, treasury shares are reissued to related parties without independent shareholder approval.

<u>Question 3</u>

Do you agree with the proposal to require a resale of treasury shares (whether on-market or off-market) to be subject to a moratorium period after a share repurchase?

Yes

Please provide reasons for your views.

- As explained in our response to question 1, we generally do not consider it prudent capital management for a company to frequently repurchase and reissue their own shares on the Exchange. We believe company management should not be encouraged to divert their attention from running the business to making trading profits through such transactions. A moratorium period would therefore be essential, but we believe a moratorium period of 30 days would be too short to be fit for purpose for a resale of treasury shares on the Exchange.

- BlackRock's Investment Stewardship team generally does not vote in support of reissuance mandates requested by Hong Kong listed issuers to reissue repurchased shares in a year, with a view that it would be generally imprudent for a company to reissue shares in the next 12 months following a repurchase. By the same token, we believe a moratorium period for a resale of treasury shares on the Exchange should be 12 months or longer.

- BlackRock recognizes an issuer's need for the flexibility to raise funds and the capability to do so quickly at times. Hence, we are not suggesting that a longer moratorium period should similarly be applied to new share issuance or off-market reissuance of treasury shares. We believe a moratorium period of 12 months or more for on-market resale of treasury shares only could foster prudent capital management without undermining the flexibility needed to meet any emergency funding needs.

Question 4

Do you agree with the proposal to require an on-Exchange share repurchase to be subject to a moratorium period after an on Exchange resale of treasury shares?

Yes

Please provide reasons for your views.

- As explained in our response to question 1 and 3, we generally do not consider it prudent capital management for a company to frequently repurchase and reissue their own shares on the Exchange. We believe company management should not be encouraged to divert their attention from running the business to making trading profits through such transactions. A moratorium period would therefore be essential.

- While we similarly consider a 30-day moratorium period too short in general for prudent capital management, we also recognize that, unlike share issuance where companies can resort to new share issuance or off-market reissuance of treasury shares to meet emergency funding needs, companies generally only repurchase shares on the market. At times, companies may need to provide signals to the market and support their share price in a timely manner, and a long moratorium period may significantly undermine the flexibility needed for doing so. Therefore, we support the Exchange's proposal to require an on-market share repurchase to be subject to a moratorium period of 30 days after an on-market resale of treasury shares.

Question 5

Do you consider that the moratorium periods (in either direction) should be shorter than 30 days? If so, please share with us your views on the appropriate duration of the moratorium periods and the reason for your suggestion including your views on how the considerations in paragraph 68 should be addressed.

No

Question 6

Do you agree with the proposal that dealing restrictions described in paragraph 69 under Proposal (2)(b) above shall be imposed on a resale of treasury shares on the Exchange?

No

Please provide reasons for your views.

• For the avoidance of doubt, we agree with the Exchange's proposal to apply certain dealing restrictions to on-market resale of treasury shares. However, we are concerned about whether the restrictions described in the consultation paper would be sufficient to alleviate the risks of insider trading.

• As explained in our response to question 1, allowing companies to trade their own shares would heighten the risks of insider trading. A company's management is a company insider and hence is highly likely to information advantages over investors in the market. Despite the proposed one-month restricted period preceding results announcements, we are concerned about information asymmetry when most Hong Kong issuers only report financial results twice a year. When a company can trade its own shares in the subsequent five months following a results announcement, there is plenty of time for insider information to accumulate. Although the proposed restricted period is in alignment with the current regulation on share buyback, we believe stricter regulation is warranted for the resale of treasury shares given the potential negative impact on share price.

• We suggest the Exchange consider replacing the proposed restricted period with a two-month trading period following a results announcement when issuers can reissue treasury shares on the Exchange. This would be effectively similar to a one-month restricted period if a company reports its financial results quarterly. Importantly, the proposed one-month restricted period preceding results may disincentivise companies from providing more frequent disclosure to investors, as they would be subject to more restricted periods as a result. On the contrary, a permissive trading period following results announcements could encourage more frequent disclosure, reducing the information asymmetry between investors and management. Companies reporting quarterly results would benefit from more trading periods to reissue treasury shares on the Exchange. Therefore, we encourage the Exchange to frame this dealing restriction in terms of the trading period following a results announcement, rather than a restricted period prior to that.

- In addition, we are concerned that the heightened risks of insider trading, whether perceived or actual, combined with the weakening of the utility of share buybacks as a capital return mechanism could materially undermine the confidence of long-only investors when trading in the Hong Kong market, with potential negative impact to market liquidity.

<u>Question 7</u>

Do you agree with the proposals for an on-market resale of treasury shares as described in paragraph 70 under Proposal (2)(b) above?

Yes

Please provide reasons for your views.

- We agree with the proposal for issuers to disclose their on-market resale of treasury shares through a next day disclosure return. We also understand that the submission of place information to the Exchange will be impracticable under the auto-matching trading system.

- However, we would also like to encourage the Exchange to consider requiring an issuer to announce when it has reissued treasury shares above a certain threshold of its total issued shares on the Exchange in the past 12 months. The announcement should include an explanation of the reasons and the use of proceeds of the reissuance to provide clarity to shareholders. We believe a reasonable threshold that triggers a disclosure requirement should be below 5%, which is the sub-limit on on-market resale of treasury shares we proposed in response to question 1. The threshold should take into consideration the pattern of the historical uses of the general mandate in the recent years.

<u>Question 8</u>

Do you agree with the proposal relating to new listing applicants as described in Proposal (3) above?

No

Please provide reasons for your views.

• Given we do not agree with the proposal to allow holding of treasury shares, we also do not agree to permit new listing applicants to retain treasury shares.

Question 9

Do you agree with the proposal to require issuers (being holders of treasury shares) to abstain from voting on matters that require shareholders' approval under the Listing Rules as described in Proposal (4)(a) above?

Yes

Please provide reasons for your views.

• If issuers, being holders of treasury shares, were allowed to vote, it would create a significant loophole for controlling shareholders to disproportionally increase their votes, and hence control over the company, through share repurchases in the form of treasury shares.

Question 10

Do you agree with the proposal to disregard treasury shares for calculating an issuer's issued shares and voting shares under the Rules as described in Proposal (4)(b) above?

Yes

Please provide reasons for your views.

• If treasury shares were not disregarded in these calculations, it would create a number of loopholes, such as a substantial shareholder effectively breaching the 30% ownership threshold without triggering a mandatory offer.

Question 11

Do you have any comments regarding the different treatment of treasury shares when calculating an issuer's issued voting shares under the proposed Rules and Part XV of the SFO as described in paragraph 77 above?

No

Question 12

Do you agree with the proposal to require an issuer to disclose in the explanatory statement its intention as to whether the repurchased shares will be cancelled or kept as treasury shares as described in Proposal (4)(c) above?

Yes

Please provide reasons for your views.

• The proposed disclosure requirement would be important for investors to identify the signal a company is sending through a share repurchase. When repurchased shares are not cancelled but kept as treasury shares, from our experience in other markets, investors typically expect these treasury shares to return to the market at some point and do not exclude them from earnings per share (EPS) calculations in their modelling, in contrast to the accounting treatment.

<u>Question 13</u>

Do you agree with the proposal to clarify that a resale of treasury shares by an issuer or its subsidiary includes resale of treasury shares through their agents or nominees as described in Proposal (4)(d) above?

Yes

Please provide reasons for your views.

• The proposal is important for avoiding loopholes that could enable issuers to bypass the regulatory requirements proposed by the Exchange.