

## Part B Consultation Questions

1. Should the Exchange in no circumstances allow companies to use WVR structures?

No

Please give reasons for your views below.

We welcome the serious consideration given by the Hong Kong Stock Exchange to the question of whether companies with WVR structures should be allowed to list in Hong Kong.

The existing prohibition on listing such companies is considered to be detrimental to the competitiveness of Hong Kong as a listing venue, which is unfortunate for Hong Kong's investors and its financial services industry. The continuing and apparently increasing popularity of the NYSE and NASDAQ for listing Chinese technology company stocks raises questions in terms of Hong Kong's position as the gateway to international capital for Chinese companies. This will be particularly true if WVR structures are used by more Chinese companies in other industry sectors in the future.

The Exchange's securities market led the world in IPO funds raised for three consecutive years ending in December 2011.<sup>1</sup> In 2012 and 2013, however, the NYSE was the top exchange for IPO funds raised, and it is set to take the top spot again in 2014. In the first nine months of 2014, the NYSE ranked first by deal value while Hong Kong ranked second.<sup>2</sup> In the first three quarters, the IT sector saw the most IPOs, with 107 IPOs globally raising US\$42.9 billion. Of these, 39 listed on the NYSE and Nasdaq raising US\$35.2 billion.<sup>3</sup>

The loss of Alibaba's IPO to the NYSE this year was unfortunate given that the Exchange has long been the natural international fund-raising venue for Chinese companies. It was also disappointing for Hong Kong investors who were allocated very few of Alibaba's IPO shares.

Our view is that serious consideration must be given to allowing companies with WVR structures to list on the Exchange in order to ensure Hong Kong's continued competitiveness and relevance. We also note that the China Securities Regulatory Commission is considering allowing internet-based companies and companies with innovative technologies which are not yet profitable to list on a new third board in Shenzhen.<sup>4</sup> This raises the possibility that in future, Chinese technology companies will be able to by-pass both the US and Hong Kong exchanges, and further underlines the need for Hong Kong to innovate to keep abreast of developments in other markets if it is to continue to offer local and international investors access to China's most innovative and popular companies.

<sup>1</sup> Hong Kong Exchanges and Clearing Limited. "Hong Kong Leads World in IPO Fundraising for Three Consecutive Years and Attracts more International Listings". January 2012.

<sup>2</sup> Ernst & Young, "EY Global Trends 2014 Q3".

<sup>3</sup> Ibid.

<sup>4</sup> China Securities and Regulatory Commission. "Press Conference on October 17, 2014".

Having considered and followed debate in recent months, I have undergone a change a view. Prior to this debate, I was in principle, against any form of WVR structure, which gave one class of shareholders preferential rights over other classes. I remain of this view in respect of existing listed companies, and would hope that the Exchange, should any form of WVR structure be introduced, firmly resist and attempts by listed companies to restructure their share structures.

The Hong Kong market has matured significantly in the last two decades, and I now believe that, globally and domestically, there is sufficient market maturity to allow some forms of WVR structures. In addition, the disclosure regime adopted by Hong Kong regulators, as well as the scrutiny I am sure they will apply to WVR proposals, will mitigate the risk to investors and safeguard the market

I make these observations, not with commercial considerations in mind, but from an in-principle belief that the market can absorb such structures, in certain restricted circumstances.

**Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.**

2. Should the Exchange permit WVR structures:

- (a)  for all companies, including existing listed companies; or
- (b)  only for new applicants (see paragraphs 147 to 152 of the Concept Paper)

Please give reasons for your views below.

We consider that WVR structures should only be allowed for new listing applicants, since potential investors would invest with awareness of the risks associated with the structure which would be disclosed in the prospectus.

- (c) only for:
- (i) companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162 of the Concept Paper), please specify below which industries and how we should define such companies;
- (ii) “innovative” companies (see paragraphs 163 to 164 of the Concept Paper), please specify how we should define such companies below;
- (d) only in “exceptional circumstances” as permitted by current Listing Rule 8.11 (see paragraph 81 of the Concept Paper) and, if so, please give examples below.

**If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.**

3. If a listed company has a dual class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153 of the Concept Paper), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views below.

The restrictions on WVR mentioned in the Concept Paper are measures voluntarily adopted by listed companies in the US to limit the rights attached to multiple vote shares with the aim of improving the shares' marketability. Our view is that the restrictions to be placed on WVR structures should be a matter for negotiation between the underwriters and investors.

4. Should other WVR structures be permissible (see Chapter 5 of the Concept Paper for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views below. In particular, how would you answer Question 2 and Question 3 in relation to such restructures?

We believe that other WVR structures delivering similar results should be permitted to list if the Listing Rules and corporate governance requirements provide for structural transparency and sufficient risk disclosure. The minority shareholders in such companies should also be entitled to the same protections as minority shareholders in listed companies controlled by a single shareholder or a group of related shareholders.

5. Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V of the Concept Paper)?

No.

If so, please specify these changes with reasons below.

There should be a further consultation on detailed proposals once it has been decided that companies with WVR structures should be allowed to list. We note however that connected transactions are already highly regulated under the Listing Rules, and that these should protect minority shareholders in a WVR structure from abuse by controlling shareholders.

In particular, we do not consider that a class action regime and legal contingency fees should be preconditions to allowing the listing of WVR structures. Details of class actions and contingency fee arrangements which are available in the United States are given in the Concept Paper and this might give the impression that the current prohibition on WVR listings is somehow justified by Hong Kong's lack of a class

action regime and arrangements for payment of legal fees on a contingency basis.

However, statistics produced annually by Stanford University Law School show that shareholder class actions in the United States are brought almost exclusively to obtain compensation for losses resulting from false or misleading disclosure in financial statements. In 2013, for example, 97% of shareholder class action suits involved allegations of misrepresentations in financial documents and 84% of class action suits involved claims of securities fraud brought under section 10(b) of the Exchange Act of 1934 and Rule 10b-5 of the SEC.<sup>5</sup>

It seems that company shareholders cannot bring a class action suit in the United States to obtain redress for the type of corporate governance issues which are most likely to arise in the case of companies with WVR structures, which are likely to involve breach of directors' fiduciary duties such as failure to act in the best interests of the shareholders as a whole or conflict situations. This is because the shareholders do not have a direct claim against the wrongdoers (e.g. the company directors) because the harm done to them is incidental to the harm done directly to the company.

In the United States, the appropriate type of shareholder action where company directors breach their fiduciary duties, is a derivative action, not a class action. This allows one or more shareholders to bring a derivative action on behalf of the company against the directors, but any remedy will be granted to the company, so that minority shareholders benefit only indirectly by virtue of any increase in the company's share price. Hong Kong legislation already allows derivative actions. Thus it does not appear that a class action regime needs to be established in Hong Kong before WVR structures are allowed to list.

The SFC has also had considerable success in obtaining redress on behalf of listed company shareholders by relying on its powers under sections 212 to 214 of the Securities and Futures Ordinance.

6. Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of the Concept Paper:
- (a) Using GEM, a separate board, or a professional board to list companies with WVR structures (paragraphs 33 to 41 of the Concept Paper); and

We are in favour of allowing such companies to list either on the Main Board or on GEM, provided that if a company has a WVR structure, this is made obvious to potential investors.

- (b) The prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47 of the Concept Paper)?

<sup>5</sup> Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, "Securities Class Action Filings 2013 Year in Review". p.d 7.

7. Do you have any other comments or suggestions regarding WVR structures?

We would emphasize the importance of shareholder protection and would urge the Exchange to consider how to deal with the possibility of a board being able to entrench itself indefinitely, even when this is no longer in a company's best interests. A possible solution would be to ensure that controllers are only allowed director nomination rights, so that the appointment would always be subject to shareholder approval and the controllers would be prevented from voting due to their material interest in the appointment.

We are however in favour of allowing companies with WVR structures to list. It is important that Hong Kong investors should have the opportunity to invest in China's most successful companies and this will be much more convenient if they list in Hong Kong, rather than in the US. We would like to see companies with WVR structures being able to list in Hong Kong as soon as is reasonably practicable. In the meantime, it would suggest that the regulators could consider allowing such companies to list under the existing exceptional circumstances provision under Listing Rule 8.11.