

21 August 2017

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

Submitted via email to: response@hkex.com.hk

RE: Concept Paper on New Board

Dear Sir/Madam,

BlackRock¹ is pleased to have the opportunity to respond to the “Concept Paper on New Board”, issued by the Hong Kong Exchanges and Clearing Limited (HKEX).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Concept Paper and will continue to contribute to the thinking of the Hong Kong Exchanges and Clearing Limited on any issues that may assist in the final outcome.

Executive summary

BlackRock appreciates the efforts of the Concept Paper on New Board as HKEX tries to make the market more appealing by opening up to a more diverse range of companies. However, we fundamentally disagree with the core feature of the proposed New Board – the tolerance of the so called unconventional corporate governance structures, with weighted voting rights (WVRs) being the most obvious example.

BlackRock invest in Hong Kong listed companies on behalf of our clients who comprise both individuals and institutional asset owners including pension funds and insurance companies. As a fiduciary managing assets for our clients, BlackRock strongly supports the principle of “One-Share-One-Vote” (OSOV). It is at the core of corporate governance that, to reduce the agency problem, all shareholders need to effectively monitor companies. WVRs disenfranchise entire class(es) of shareholders and amplify the risk of the controlling shareholders and the management extracting private benefits to the detriment of the company’s and shareholders’ long-term economic interests.

Moreover, voting is a core accountability mechanism for investors. In our experience, companies with WVRs have less incentive to engage with those shareholders with inferior voting rights.

BlackRock’s support of the OSOV principle is public:

- BlackRock’s [Global Corporate Governance Guidelines & Engagement Principles](#) indicate that “there should be one vote for one share” and our [US Proxy Voting Guidelines](#) criticize WVRs “as it may have the effect of denying shareholders the opportunity to vote on matters of critical economic importance to them”.
- The [Common Sense Corporate Governance Principles](#), signed by BlackRock CEO Larry Fink, support the equality of shareholders and ask for a sunset provision when a company has WVRs as this “is not a best practice”.

¹ BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

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- The [Corporate Governance Principles for US Listed Companies](#), endorsed by BlackRock, defend the one-share, one-vote standard. Companies with WVR structures are asked to “establish mechanisms to end or phase out controlling structures at the appropriate time”.

While we have provided our comments to the specific questions in the attached response, we would like to point out that we answered those questions in the hypothetical scenario that the HKEX is proceeding with the proposed New Board. Our comments should not be taken as an endorsement to the launch of the New Board itself. In fact, in our [response](#) to the Concept Paper on Weighted Voting Rights by HKEX in 2014 we stated that “In BlackRock’s view, under no circumstances should the Exchange allow companies to use weighted voting right (WVR) structure”.² Our view has not changed.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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² Our response is available here: <https://www.blackrock.com/corporate/en-zz/literature/publication/weighted-voting-rights-hong-kong-stock-exchange-113014.pdf>

Consultation Questions

Please reply to the questions below that are raised in the Concept Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf>

Please indicate your preference by checking the appropriate boxes.

Where there is insufficient space provided for your comments, please attach additional pages.

- 1. What are your views on the need for Hong Kong to seek to attract a more diverse range of companies and, in particular, those from New Economy industries to list here? Do you agree that the New Board would have a positive impact on Hong Kong's ability to attract additional New Economy issuers to our market?**

Please give reasons for your views.

We agree that it is good for the HKEX to attract a more diverse range of companies to list in Hong Kong. However, we do not think the creation of the New Board would necessarily guarantee a positive impact on Hong Kong's ability to attract the so called New Economy companies.

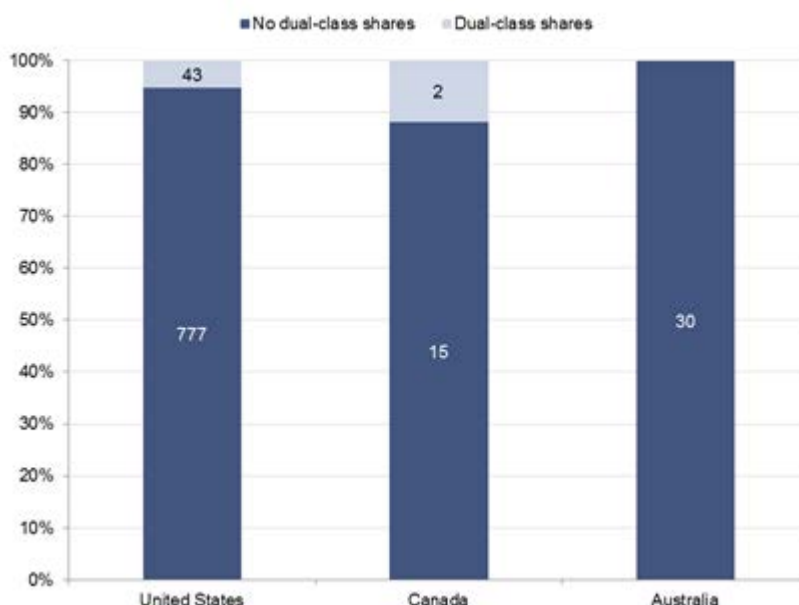
The main differentiation of the New Board from the Main Board is that companies are allowed to establish unconventional corporate governance structure to preserve the founders' control over the company after the IPO even when the founders' equity ownership no longer represents the majority ownership. Such unconventional corporate governance structure may include the creation of different classes of shares with different voting rights (Weighted Voting Rights, or WVRs) or a partnership structure similar to that adopted by Alibaba that grants the founding management effective control over the board.

We do not believe there is enough evidence to support the notion that WVR structure alone will attract New Economy companies or that the WVR structure is a key determination of listing location. Based on Chart 1 below³, despite Canada allowing WVR structure the number of listed tech and biotech companies is less than that in Australia, where WVR structure is prohibited. Moreover, tech and biotech stocks with WVR structures constitute only around 5% and 12% of the US and Canada listed tech and biotech universe respectively, which demonstrates the limited interest such companies have in this type of structures.

³ The analysis was based on all tech and biotech listed companies in the respective countries as of 15 March 2017, based on GICS sector "information technology" and "biotechnology" in Bloomberg's universe of listed companies. Only companies with available data regarding their dual class shareholdings were screened – this takes out companies that are not in Bloomberg's ESG universe. List of companies were also adjusted to remove double counting by only including primary listed tickers.

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Chart 1: Share class structure of listed tech & biotech stocks



Source: Bloomberg

A variety of factors go into a company's decision for the listing venue. These factors include the familiarity of the investment community with the business segment, the availability and depth of research covering both the sector and the company which has a direct impact on the valuations accorded to them, and the quality of shareholders. Based on our research and engagement experience, another important consideration for companies are the corporate governance requirements and the cost of compliance.

We reviewed a number of non-US technology companies which have listed in the US. Companies incorporated outside of the US and listed on US exchanges are often classified as a Foreign Private Issuer (FPI). FPI status offers the company exemption from a number of requirements relating to corporate governance and disclosures that apply to companies under the US securities laws, as well as flexibility in relation to other requirements.

An analysis of 30 non-US companies with a WVR structure shows that all are incorporated outside of the US in jurisdictions with relatively lax corporate governance requirements. These companies, qualified as FPIs, are only required to conform to the corporate governance standards in their countries of incorporation where there is:

- No requirement to have a majority of independent directors;
- No requirement to have an audit committee;
- No requirement to have a compensation committee;
- No requirement to hold annual general meetings;
- No requirements to vote on amendments to the terms of equity compensation.

On the basis of the above, we believe there are factors other than the WVR structure that attracted these companies to list in the US and we do not agree with the argument that the New Board would necessarily lead to more listings of New Economy companies.

2. What are your views on whether the targeted companies should be segregated onto a New Board, rather than being included on the Main Board or GEM?

Please give reasons for your views.

Should the HKEX decide to allow the listing of pre-profit companies and companies with unconventional corporate governance structure (the latter of which we do not support), it

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appears to be a better structure to have the targeted companies segregated onto a New Board, rather than being included on the Main Board or GEM. We would also like to highlight our view that the Main Board should be kept strictly intact from the targeted companies as its status as a premium board with companies of proven track record and strong corporate governance standards must be maintained. As long as the unconventional corporate governance structure remains, such companies should not be allowed to migrate to the Main Board regardless of their profitability or market cap.

Voting is a core accountability mechanism for investors. In our experience, companies with WVRs have less incentive to engage with those shareholders with inferior voting rights.

- 3. If a New Board is adopted, what are your views on segmenting the New Board into different segments according to the characteristics described in this paper (e.g. restriction to certain types of investor, financial eligibility etc.)? Should the new Board be specifically restricted to particular industries?**

Please give reasons for your views.

In the event a New Board is created, we can see certain rationale of dividing the New Board into different segments according to the characteristics described in this Concept Paper. It could help to shield the less-sophisticated investors away from pre-profits companies that are inherently riskier.

We do not see any reason why the New Board should be restricted to any particular industries. There should not be a subjective assessment of which industries are more entitled to preferential treatment than others.

- 4. What are your views on the proposed roles of GEM and the Main Board in the context of the proposed overall listing framework?**

Please give reasons for your views.

The roles of GEM and the Main Board in the context of the proposed overall listing framework looks reasonable given the listing standards of these two boards will not be lowered with the creation of the proposed New Board. However, we would like to further emphasize our view that any migration from the New Board to the Main Board or GEM needs to be strictly subject to the listing requirements of the respective boards.

- 5. What are your views on the proposed criteria for moving from New Board PRO to the other boards? Should a public offer requirement be imposed for companies moving from New Board PRO to one of the other boards?**

Please give reasons for your views.

There should be no fast-track migration mechanism between the New Board and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. Any New Board PRO listing wishing to list on the other boards must meet all the admission criteria and other listing requirements of the relevant board, as stated in paragraph 127.

We think a public offer should be required in the event of any migration from New Board PRO to the other boards in order to provide a fair and transparent access to retail investors that the other boards are open to.

- 6. What are your views on the proposed financial and track record requirements that would apply to issuers on New Board PRO and New Board PREMIUM? Do you agree that the proposed admission criteria are appropriate in light of targeted investors for each segment?**

Please give reasons for your views.

The proposed financial and track record requirements look reasonable.

However, we have significant concerns regarding the proposed exemptions for applicants to the New Board from the requirement to provide equivalent shareholder protection when they have a primary listing in jurisdictions with regulatory cooperation measures in place with the SFC, as stated in Paragraph 139. The proposed complete removal of the “centre of gravity” test under the 2013 JPS is particularly problematic. We discuss our views more in details in our comments to Question 9.

7. What are your views on whether the Exchange should reserve the right to refuse an application for listing on New Board PRO if it believes the applicant could meet the eligibility requirements of New Board PREMIUM, GEM or the Main Board?

Please give reasons for your views.

The Exchange should reserve the right to refuse an application for listing on New Board PRO if it believes the applicant could meet the eligibility requirements of any of the other boards. Access to investment opportunities should not be restricted to only Professional Investors unless there is sufficient ground such as when a business is in a pre-profits stage and an effective assessment of the inherent risk requires a level of financial sophistication that is not common among retail shareholders.

8. What are your views on the proposed requirements for minimum public float and minimum number of investors at listing? Should additional measures be introduced to ensure sufficient liquidity in the trading of shares listed on New Board PRO? If so, what measures would you suggest?

Please give reasons for your views.

Liquidity and a fair market price are shaped by having a broad base of investors investing or following a stock. Historically whether in GEM or the Main Board this has been an issue for listings in Hong Kong. Our view would be to increase the minimum number of unconnected investors to avoid the circumstances of “friends and family”- led transactions when a new shareholder register is dominated by connected parties to the listing company. There needs to be more scrutiny around the type of investors rather than just the pure number.

We are concerned with the requirement of a minimum public float of 25%. This may deter attractive companies from listing given it is a significant proportion of their value. If the New Board is targeted at growth industries such as technology or healthcare, then being able to sell less than 25% encourages companies to list at an earlier stage without resulting in a significant dilution for the founders. This could help to reduce the needs of the founders to resort to unconventional corporate governance structures in order to preserve their control. In other markets we have seen a free float of 10%-15% being highly effective in encouraging exciting growth companies to list at an earlier stage, which may present a better investment opportunity for investors as well.

9. What are your views on whether companies listed on a Recognised US Exchange that apply to list on the New Board should be exempted from the requirement to demonstrate that they are subject to shareholder protection standards equivalent to those of Hong Kong? Should companies listed elsewhere be similarly exempted?

Please give reasons for your views.

US incorporated companies listed on a Recognised US Exchange such as the NYSE and NASDAQ are subject to corporate governance requirements that are comparable to those of Hong Kong. Therefore, when they apply to list on the New Board, it should not raise significant concerns to exempt these companies from the requirement to demonstrate that they are subject to shareholder protection standards equivalent to those of Hong Kong.

However, under the proposal to remove the “centre of gravity” test under the 2013 JPS in its entirety for any secondary listing applications to New Board, there would be no restriction on the secondary listing of companies from Greater China. As discussed in our comments often, many Chinese companies listed in the US are incorporated outside of the US in jurisdictions with relatively lax corporate governance requirements. Therefore US listing does not automatically afford shareholders protection in the aspect of corporate governance. As an example, some of these FPI companies such as Baidu and JD.com do not even hold annual shareholder meetings. If exemption is granted to these FPIs as proposed, investors in Hong Kong will be exposed to companies whose corporate governance standards are significantly lower than what is currently required in Hong Kong. However, Investors of the secondary listing are in a much more vulnerable position because in the US one of the potential deterrents to corporate governance deficiency associated with FPIs is the ability of shareholders to bring class action lawsuits on a contingent fee basis if they are treated unfairly. Investors of the secondary listing of an FPI in Hong Kong cannot initiate class action nor can they participate in class action lawsuits initiated by investors of the primary listing in the US.

These companies should meet the corporate governance requirements in Hong Kong to afford shareholders a decent level of protection against corporate mis-management. Taking into consideration the heightened uncertainties of pre-profits companies, we also do not think New Board PRO should be treated with more lax requirements simply because it will be open to only Professional Investors as suggested in Paragraph 139.

There is one particular shareholder protection mechanism in Hong Kong that we believe should not be exempted for any secondary listing application to the New Board in any situation: the requirement of independent shareholder approval for material related-party transactions. This requirement is particularly relevant for companies with WVR structures applying for a secondary listing in Hong Kong. This is because the risk of abusive related-party transactions is the greatest when the company is a controlled entity.

Controlled companies are not new to investors in Hong Kong. For decades, investors had suffered from abusive corporate dealings between affiliated parties, until the independent shareholder approval rule was introduced in the 1980s. This rule has proven to be quite successful in that it provides minority shareholders with sufficient influence over material transactions that are most exposed to conflicts of interest and therefore helps to build trust in the market. Requiring all companies with WVR structures wishing to have a secondary listing to comply with this rule affords non-controlling shareholders a certain degree of protection where it is needed the most.

For this mechanism to be effective, however, the system needs to be improved to facilitate all shareholders to participate in voting. At the moment, there is no requirement on intermediaries such as banks and brokers to notify their clients about an upcoming vote. Even if a retail shareholder is diligent enough to keep track of all the corporate announcements, he or she still needs to go through a lengthy administrative process to instruct the intermediaries to vote in a certain way or to appoint them to attend the meeting in person. As a result the retail participation in voting is unsurprisingly very low.

10. What are your views on whether we should apply a “lighter touch” suitability assessment to new applicants to New Board PRO? If you are supportive of a “lighter touch” approach, what relaxations versus the Main Board’s current suitability criteria would you recommend?

Please give reasons for your views.

As mentioned in our comments to Question 9, we do not think New Board PRO should be applied with a “lighter touch” simply because it will only be open to Professional Investors, especially considering the riskier nature of these pre-profits companies.

11. What are your views on whether the New Board PRO should be restricted to Professional Investors only? What criteria should we use to define a Professional Investor for this purpose?

Please give reasons for your views.

The New Board in its current design should be restricted to Professional Investors and we defer to section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance⁴ for the definition of Professional Investors. However we do not believe that by restricting access to them it can overcome the shortcomings of a) companies not required to provide equivalent shareholder protection standards, b) no restriction on secondary listings by Mainland Chinese companies, and c) WVR structures permitted as discussed in our response to the previous questions.

12. Should special measures be imposed on Exchange Participants to ensure that investors in New Board PRO-listed securities meet the eligibility criteria for both the initial placing and secondary trading?

Please give reasons for your views.

We agree that Exchange Participants should be responsible to ensure that investors in New Board PRO-listed securities meet the eligibility criteria for both the initial listing and secondary trading.

13. What are your views on the proposal for a Financial Advisor to be appointed by an applicant to list on New Board PRO, rather than applying the existing sponsor regime? If you would advocate more prescriptive due diligence requirements, what specific requirements would you recommend be imposed?

Please give reasons for your views.

In other markets such as the UK and Japan, a financial advisor sitting in between a company and the investment banks is an ineffective addition to the process in our view. IPOs that have taken place with a financial advisor leading a process on behalf of the company have led to worse outcomes for both companies and investors. Financial advisors do not have direct investor relationships and therefore dilute the feedback in the price discovery process. In addition, they are paid out of the same fee pool as the investment banks. This further reduces the incentives for the banks to provide high-quality service.

We would be supportive of limiting the number of banks leading a deal, i.e. banks working directly with management and shaping the book building process, to three banks only. We believe by giving more accountability to a small group of banks it will greatly improve the outcomes for all involved.

Limiting the number of banks should also have a positive impact on the due diligence process undertaken by them. At the moment, we see a large inconsistency in the depth of the due diligence process. Some banks conduct only minimal reputational checks and minimal review of connected parties, using public records only. Limiting the number of banks should lead to increased accountability for each bank and with the heightened reputational risk banks tend to conduct due diligence that is deeper and more thorough. To further ensure the quality of due diligence, we also think the sponsor group needs to be created several months prior to the IPO to allow time for extensive work to be done.

14. What are your views on the proposed role of the Listing Committee in respect of each segment of the New Board?

Please give reasons for your views

⁴ <http://www.sfc.hk/web/EN/pdf/laws/sfo/1/Ordinance/5%20of%202002.pdf>

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Given the increased risks with companies with either no profit history and/or unconventional corporate governance structures, together with the conflicts associated with HKEX being a listed for-profit entity itself, we believe such applications should be vetted by the HKEX Listing Department with final approval resting with the SFC. This will ensure adequate independent regulatory oversight for those shareholders wishing to invest in these companies.

Please refer to our comments on the desired listing governance structure including the composition, roles and responsibilities of the Listing Committee⁵ in our submission to the Joint Consultation Paper on Proposed Enhancements to the Stock Exchange of Hong Kong Limited's Decision-Making and Governance Structure for Listing Regulation in November 2016.

15. Do you agree that applicants to listing on New Board PRO should only have to produce a Listing Document that provided accurate information sufficient to enable Professional Investors to make an informed investment decision, rather than a Prospectus? If you would advocate a more prescriptive approach to disclosure, what specific disclosures would you recommend be required?

Please give reasons for your views.

We do not agree that listing applicants to the New Board PRO should only be required to produce a Listing Document rather than a Prospectus. Financial transparency is necessary for investors to evaluate the fundamentals and risk profiles of a business. Such transparency is even more essential for investors to make an informed investment decision in light of the riskier nature of pre-profit companies.

Specifically, we would like to see companies disclose their financial track record in the most recent three years and possibly longer, the identities of substantial shareholders as per defined under the SFO and shareholders with WVRs and changes in their holdings in the same period.

16. What are your views on the proposed continuous listing obligations for the New Board? Do you believe that different standards should apply to the different segments?

Please give reasons for your views.

We think the proposed continuous listing obligations for the New Board look reasonable. In particular, we think the rules around related-party transactions of the Main Board should be applied to the New Board as discussed in our comments to Question 9. We do not believe different standards should apply to the different segments.

17. For companies that list on the New Board with a WVR structure, should the Exchange take a disclosure-based approach as described in paragraph 153 of this Concept Paper? Should this approach apply to both segments of the New Board?

A disclosure-based approach will not be sufficient to offset the shortcomings of the WVR structure, as discussed above. At a minimum, mandatory safeguards should apply.

18. If, in addition, you believe that the Exchange should impose mandatory safeguards for companies that list on the New Board with a WVR structure, what safeguards should we apply? Should the same safeguards apply to both segments of the New Board?

Please give reasons for your views.

If the HKEX were to adopt the WVR structure with the establishment of the New Board, we believe the Exchange should impose mandatory safeguards for companies that list on the New Board with a WVR structure in addition to disclosure requirements described in Paragraph 153.

⁵ Our response is available here: <https://www.blackrock.com/corporate/en-us/literature/publication/hong-kong-sfc-proposed-enhancements-stock-exchange-listing-regulation-111616.pdf>

By placing more voting rights to the founders and / or management than what is justified by their equity ownership on a proportionate basis, WVR structures exacerbate the agency problems that arise from a separation of ownership from management associated with modern corporations. As a result, investors holding the class of shares with inferior voting rights have limited voice to get themselves heard by the management team when there are signs of corporate mis-management. Therefore, we agree that such companies should be required to prominently disclose that they have a WVR structure and fully elaborate the risks and unintended consequences associated with the structure. Additional disclosure such as the identities of WVR holders, their voting activities and the details of any transfers of WVR shares should also be made to provide full transparency to investors.

Additional safeguards should also be made mandatory to provide a certain level of protection for investors in WVR companies. Designing effective mandatory safeguards such as sunset clauses is a complex matter and requires careful deliberation by the HKEX and the financial industry. If the HKEX were to go ahead and allow companies with WVRs to list in the Hong Kong, we urge the HKEX to conduct another consultation focused on the protection mechanisms that need to be introduced to afford shareholders sufficient protection in light of the heightened corporate governance risks associated with WVRs.

19. Do you agree that the SEHK should allow companies with unconventional governance features (including those with a WVR structure) to list on PREMIUM or PRO under the “disclosure only” regime described in paragraph 153 of the Concept Paper, if they have a good compliance record as listed companies on NYSE and NASDAQ? Should companies listed elsewhere be similarly exempted?

Please give reasons for your views.

As explained in our comments to Question 9, we do not think such concession should be granted due to concerns in relation to FPIs and the fact that investors of secondary listing cannot initiate class action or participate in class action lawsuits initiated by investors of the primary listing in the US. Safeguards should be required of all companies with a WVR structure seeking a primary or secondary listing on the New Board to afford investors the minimum level of protection.

20. What are your views on the suspension and delisting proposals put forward for the New Board?

Please give reasons for your views.

We think the proposals on the suspension and delisting look reasonable in particular with regards to financial information release. Financial information disclosure should be made timely and any failure to do so should lead to significant consequences. We would appreciate additional clarity on the criteria on which the HKEX will consider that a company or its business is no longer suitable for listing. While delisting has a deterrent effect on corporate misdemeanour, it is detrimental to investors if they are left holding unlisted shares.

21. Should New Board-listed companies have to meet quantitative performance criteria to maintain a listing? If so, what criteria should we apply? Do you agree that companies that fail to meet these criteria should be placed on a “watchlist” and delisted if they fail to meet the criteria within a set period of time?

Please give reasons for your views.

We support a free market and the idea of quantitative performance criteria would introduce constraints on this concept. There are a plethora of ways to measure company performance and delisting should not be based on purely quantitative criteria.. A performance metric purely

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based on accounting profit would see companies such as Uber highlighted as having a continuation of losses.

Moreover watchlists can create more problems than they solve; for example: which regulatory body will have oversight of such lists, the process to remove a company from a watchlist and how investors will interpret a company being added to such a list. Further, watchlists may encourage investors to divest and unnecessarily precipitate the demise of a listed company.

This issue needs considerable further thought.

22. Do you consider that an even “lighter touch” enforcement regime should apply to the New Board (e.g. an exchange-regulated platform)?

Please give reasons for your views.

We strongly disagree with the notion that an even “lighter touch” enforcement regime should apply to the New Board. The New Board is expected to host companies with limited or no proven profitability and unconventional corporate governance structures and hence will expose investors to potentially higher risks and inferior shareholder protection. A “lighter touch” enforcement regime will only serve to further exacerbate the problems. If companies breach the already-laxer thresholds, enforcement should be strictly upheld.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the Concept Paper on New Board and will continue to work with HKEX on any specific issues which may assist in the discussion of weighted voting rights.