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Asian Corporate Governance Association (ACGA)

“"Weighted Voting Rights –

Increasing Governance Risk in Hong Kong"

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Agenda

1. History of weighted voting rights (WVR) in Hong Kong
2. Asian contagion
3. What is wrong with WVR rules in Hong Kong?
4. What is wrong with WVR longer term?
5. WVR and stewardship
6. "CG Watch" market rankings in Asia
7. Concluding remarks: Embracing tech firms

1. History of WVR in Hong Kong

SFC questions HKEX proposals. Asks questions it could not answer

SFC remains sceptical, but political battle lost. New Hong Kong government firmly in support of DCS

Alibaba tells HK to accept its partnership structure

HKEX consults on "WVR"

Alibaba lists on the NYSE

HK convinced it "lost" Alibaba

HKEX drops WVR idea ("for now")

Alibaba buys SCMP

HKEx consults on new "third board" with WVR

Market rejects third board, but WVR gets some support

HKEx declares victory. WVR to mainboard

HKEx does quick 4-week consult on new rules

WVR introduced from April 30

2013 2014 2015 2016 2017 2018

WVR contagion in Asia

1. **February 2017**: SGX consults on WVR (also called DCS for "dual-class shares"); delays decision until outcome of Hong Kong consultation.
2. **June 2017**: HKEX consults on WVR in context of a new "Third Board".
3. **December 2017**: Third Board proposal fails, but HKEX declares "overwhelming support" and moves ahead on WVR, pre-revenue biotech listings, and secondary listings of China tech firms listed in the US.
4. **January 2018**: Head of Fair Trade Commission in Korea mulls allowing DCS for new listings on KOSDAQ, the second board. *Chaebols* say they should have it too.
5. **February 2018**: China announces a plan for trading in US-listed China tech firms, many of which have WVR, through "China Depository Receipts".
6. **February - March 2018**: HKEX consults on new rules, followed by SGX (with an almost identical set of proposals).
7. **May 3, 2018**: Xiaomi, a smartphone maker, submits draft prospectus to HKEX for listing with a WVR structure. Trading starts on July 9.

What is wrong with WVR in Hong Kong?

HKEX rule changes have numerous weaknesses:

- **Ring-fencing to new IPOs only**: This is unlikely to last and/or existing issuers will find workarounds such as spin offs.
- **Only "innovative growth companies can apply":** How do you define "innovative"? What is genuinely innovative about the business models of Xiaomi or Meituan? "High tech" does not always mean "innovative".
- **Selective approval process:** HKEX and its Listing Committee will find it difficult to make suitability judgments on a case-by-case basis.
- **Weak safeguards:** No time-based sunset clause—which is what global investors most want to see. Other CG protections are of limited value.
- **Enforcement difficult:** HKEX will find it difficult to enforce the new rules (eg, limiting WVR to key individuals/founders).

What is wrong with WVR longer term?

Long-term risks to Hong Kong:

- **Valuation discounts:** Institutional investors routinely discount firms with poor corporate governance. WVR hardwires a governance flaw into firms. If WVR becomes common in Hong Kong, the market could start to suffer an entrenched governance discount. This is not good for our pensions!

- **Weak legal remedies:** Hong Kong lacks the strong legal remedies available to shareholders in the US, such as class-action lawsuits. Investors cannot protect themselves from abusive management behaviour.

- **Corporate disclosure:** Detailed disclosure of "risk factors" is required in prospectuses in Hong Kong, but not thereafter (unlike the US). We need much greater levels of disclosure to counter-balance WVR—but there are no plans to change the rules.

- **Corporate WVR:** Having said it would restrict WVR rights to individuals only, HKEX is now planning a consultation on giving WVR rights to corporates. This means they would be entrenched in perpetuity.

WVR and “stewardship”

- WVR directly contradicts the spirit of the SFC’s “Principles of Responsible Ownership” from March 2016.
- Following the Global Financial Crisis, institutional investors around the world have taken more responsibility—and been pushed by governments to do so—for the quality of corporate governance in listed companies. That is, to act as owners or “stewards” of companies, not just traders.
- WVR undermines a core governance tool of investors, namely voting rights.
- If your vote does not count, why should your voice?

Stewardship Codes in Asia

Market (order)	Date of Adoption	Comply or explain?	Lead investor(s)?
Australia	FSC Code 2017. ACSI code 2018.	-	Selected super funds, asset managers
China	Current focus on ESG	-	-
Hong Kong (3rd)	March 2016	Voluntary	HKMA?
India (8th)	March 2017 (for insurers only)	Yes	LIC?
Indonesia	-	-	-
Japan (1st)	February 2014 (revised 2017)	Yes	GPIF
Korea (6th)	December 2016	Yes	NPS?
Malaysia (2nd)	June 2014	Yes	KWAP, EPF
Philippines	-	-	-
Singapore (5th)	November 2016	Voluntary	-
Taiwan (4th)	June 2016	Yes	BLF, Chunghwa Post
Thailand (7th)	February 2017	Yes	GPF

Source: ACGA research

Investor stewardship in practice

The importance of governance and ESG to a major global investor: Norges Bank Investment Management (NBIM) of Norway

Table 4 Priority topics for company dialogue in 2017

Category	Region	Number of meetings	Share of equity portfolio. Percent	Examples of dialogue topics
Environment	Americas	161	3.1	Climate change Deforestation Financing Water management
	Europe	219	5.2	
	Asia	101	1.1	
	Total	**481**	**9.4**	
Social issues	Americas	140	2.7	Children's rights Human rights Tax and transparency
	Europe	185	4.8	
	Asia	48	1.1	
	Total	**373**	**8.7**	
Governance	Americas	529	12.3	Board composition Corruption risk mitigation CEO remuneration
	Europe	667	14.6	
	Asia	255	4.6	
	Total	**1,451**	**31.5**	

Source: NBIM 2017

CG Watch 2016 – Market rankings

"CG Watch" report: Market scores 2010 to 2016						
(%)	**2010**	**2012**	**2014**	**2016**	**Change 2014 vs 2016 (ppt)**	**Direction of CG reform**
Australia	-	-	-	78	-	
1. Singapore	67	69	64	67	(+3)	Mostly sunny, but storms ahead?
2. Hong Kong	65	66	65	65	-	Action, reaction: the cycle of Hong Kong life
3. Japan	57	55	60	63	(+3)	Cultural change occurring, but rules still weak
4. Taiwan	55	53	56	60	(+4)	The form is in, now need the substance
5. Thailand	55	58	58	58	-	Could be on the verge of something great, if…
6. Malaysia	52	55	58	56	(-2)	Regulation improving, public governance failing
7. India	49	51	54	55	(+1)	Forward movement impeded by vested interests
8. Korea	45	49	49	52	(+3)	Forward movement impeded by vested interests
9. China	49	45	45	43	(-2)	Falling further behind, but enforcement better
10. Philippines	37	41	40	38	(-2)	New policy initiatives, but regulatory strategy weak
11. Indonesia	40	37	39	36	(-3)	Losing momentum after progress in past survey

Source: Asian Corporate Governance Association.

**CG Watch is a joint publication between ACGA and CLSA. ACGA carries out the market ranking survey.*

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CG Watch 2016: Category scores

Market category scores						
(%)	**Total**	CG Rules & Practices	Enforcement	Political & Regulatory	Accounting & auditing	CG Culture
Australia	**78**	**80**	**68**	**78**	**90**	**74**
1. Singapore	**67**	63	63	67	87	55
2. Hong Kong	**65**	63	69	69	70	53
3. Japan	**63**	51	63	69	75	58
4. Taiwan	**60**	54	54	64	77	50
5. Thailand	**58**	64	51	45	77	50
6. Malaysia	**56**	54	54	48	82	42
7. India	**55**	59	51	56	58	49
8. Korea	**52**	48	50	53	70	41
9. China	**43**	38	40	36	67	34
10. Philippines	**38**	35	19	41	65	33
11. Indonesia	**36**	35	21	33	58	32

Source: Asian Corporate Governance Association

7. Concluding remarks

1. ACGA is all in favour of embracing tech stocks—but WVR is a limited, short-term solution that will increase investment and governance risk.

2. Hong Kong should have more courage in selling the benefits of its existing "one share, one vote" regime. Numerous new economy firms have seen the value: China Literature, Yixin Group, ZhongAn Online Insurance, Razer.

3. "Tech" is not synonymous with WVR. Some of the most successful tech firms in the US do not have WVR, such as Amazon, Apple and Microsoft.

4. Now that WVR is a reality in Hong Kong, the government needs to move ahead ASAP in introducing new legal remedies and better corporate risk disclosure.

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