

23 March 2023

By email: response@hkex.com.hk

Consultation Paper on “Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers”

Dear Sir or Madam,

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in 1999. We conduct research on corporate governance and ESG in 12 markets in Asia-Pacific and advocate at the regulatory and corporate level across the region to improve standards and practices. ACGA is entirely funded by a network of 112 member firms from 20 markets, of which 70% are institutional investors with more than US\$40 trillion in assets under management globally.

We welcome the opportunity to respond to the abovementioned consultation paper published on 24 February 2023. ACGA has a few high-level comments.

Summary

ACGA is concerned that listing rules which specifically protect the interests of minority shareholders are to be repealed. We question the rationale for this move, and the manner in which it is being executed.

H share investors are invariably in a minority position, holding relatively small stakes in predominantly state-owned entities as compared to their domestic counterparts. Hong Kong Exchanges and Clearing (HKEX) plans to abolish listing rules which afford holders of H shares the ability to vote separately as a class and veto proposals (which could range from the granting of special voting rights, to the issuance and repurchase of stock) which are unfair to their group.

The rule change will effectively extinguish the ability of the minority to stave off a hardy dilution. As HKEX itself observes, this could have far-reaching implications for the liquidity and attractiveness of the H share market as a whole.

It is regrettable that the rule changes are being made without a thorough market consultation (we note HKEX believes this is not necessary), and in the absence of a cogent legal opinion.

Class distinctions

The rule amendments outlined by HKEX would no longer require separate class meetings for holders of domestic and H shares where an issuer plans to vary or abolish shareholder rights.

The rationale the Exchange gives is that it is reflecting recent rule amendments introduced in respect of PRC issuers. As part of these new regulations, specific provisions for H share issuers which were first introduced in the mid-1990s to protect minority shareholder rights will be repealed. PRC issuers must now also formulate their Articles of Association (AoA) in line with PRC Guidelines on AoA. As holders of domestic shares and H shares are no longer deemed as different classes of shareholders, HKEX concludes: “the class meeting requirement now applicable to holders of domestic shares and H shares are no longer necessary.” A market consultation on this particular issue, it says, “is not required.”

ACGA takes the view that while the PRC regulations may require issuers to refer to domestic and H shares as homogeneous stock in the same company, factually and practically, the two are separate groups. Domestic, or A shares, and H shares are non-fungible. They trade on different stock exchanges and are not interchangeable. They trade at what can be significantly different prices in different currencies, which legal title vested with different clearing houses. The PRC issuer with domestic and H shares is subject to oversight by two different regulators with separate rulebooks, disciplinary procedures and penalties.

We consider HKEX’s premise that H shares no longer exist as a separate class somewhat artificial. Clearly H shares are a different class, or group. It is then a question of whether separate rights attach to that class, or group.

Indeed, holders of H shares will still be considered by HKEX as a separate class in the context of a withdrawal of listing. The Securities and Futures Commission (SFC) will moreover still require separate approval from holders of H shares where an issuer plans to de-list from the Exchange, or take it private under takeover rules. The SFC recognizes that in this circumstance, holders of H shares would be impacted “to a much larger extent” than holders of domestic, or A shares.

We note that the SFC has issued specific guidance stating that while H shares and domestic shares are one single class under PRC law, the fact that the two are not directly fungible with each other “warrants a different approach” when applying provisions of the takeovers code to H share issuers. In respect of an offer to take an issuer private or a delisting of H shares, their interests are affected to a much larger extent than other shareholders.

By the same token, holders of H shares should be entitled to protection in the listing rules when faced with a variation/abrogation of their rights which could be disproportionately detrimental to their interests. Arbitrarily dismantling this listing rule protection is unfair.

ACGA would urge HKEX to reconsider a repeal of the rules in this respect and to re-draft provisions which specifically require issuers to facilitate separate class (or ‘group’) votes where the rights of H share investors are to be altered or abolished. This would maintain investor confidence that minority rights will continue to be protected.

ACGA notes that there are other potential variations of class rights which may impact H share investors, such as the introduction of another class of stock, and in particular ones with different voting rights.

The PRC guidelines on AoA make reference to special voting rights, a nod to dual class shares listed on the STAR board. It would take a change of China's company law to widen weighted voting rights to non-STAR companies, but the guidelines nevertheless leave the door open if this was to change.

Practicalities

ACGA and its members would appreciate clarity on some of the practical issues raised by this consultation:

- Would HKEX confirm that any vote on changes to the AoA to remove class rights of H investors should be conducted separately, ie holders of H shares vote separately from their domestic peers?
- If issuers are expected to delete references to different classes, how do the AoA provide for a separate H share vote on issues under the takeovers code?
- In the event that a vote to change the AoA is not passed by shareholders, does HKEX consider the company to be in breach of PRC regulations?

Investors in H shares could be forgiven for thinking that such a fundamental reversal of protection is significantly changing the rules of the game. ACGA would urge a rethink on this matter in the interest of regulatory certainty.

If we can assist any further, please do not hesitate to get in touch.

Best regards,

A handwritten signature in black ink, appearing to read 'Jane Moir', is positioned above the typed name.

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