



Asian Corporate Governance Association

December 20, 2004

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12/F One International Finance Centre
1 Harbour View Street
Central, Hong Kong

Attention: Charles Lee Yeh Kwong, GBS JP
Chairman

cc: Paul Chow Man Yiu, JP
Chief Executive, Hong Kong Exchanges and Clearing Ltd

By fax and post: 2868 4084

Dear Sirs,

HKEx General Mandate to Issue New Shares

It is our understanding that you are considering voluntarily lowering the general mandate—for the issuance of new shares for cash—that you will seek from shareholders at the company's next annual general meeting (AGM) in early 2005. We would like to express our support for such a move and applaud your initiative in considering such a proposal.

Earlier this year, on May 14, 2004, we wrote to you expressing our concern that the rules in Hong Kong governing such mandates did not meet international standards and, from the perspective of fair treatment of all shareholders, were not equitable in principle. We are very encouraged that you are considering lowering the mandate for your company.

While we do not wish to prescribe the level of mandate that you ask from your shareholders, we note that the accepted guidelines in the UK allow listed companies a maximum 5% mandate in any one year, no more than a cumulative 7.5% over any rolling three-year period and a maximum discount of 5% to the market price. We believe that a similar standard would be appropriate in Hong Kong for the following reasons:

- It would bring Hong Kong into line with international best practice, would be fairer to shareholders and is certain to be well-received by both international and domestic investors.

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- Although most listed companies renew these mandates through a shareholder vote at their AGMs, many do not make use of them.

According to the records of the annual meetings of the 33 Hang Seng Index (HSI) companies this year, minority shareholders have been voting against these mandates in large numbers. The mean-average vote against has been almost 15%, with a range of between 3.5% and 33% (of total votes cast)¹. At four HSI companies the vote against has been between 28-33%, while at another nine it has been between 14-21%. These numbers are significant for several reasons:

1. Resolutions at AGMs in Hong Kong are routinely passed with only a very small vote against (less than 1% in most cases). The resolution on the general mandate to issue new shares, however, has emerged as a clear exception.
2. At several HSI companies, the vote against the general mandate represents a significant percentage of their total free float (in a few cases, a majority).
3. When the actual number of votes against the mandate is analysed as a percentage of all votes cast by the public shareholders on this resolution (excluding the controlling shareholder and connected directors), it becomes clear that an overwhelming majority of public shareholders are opposing the mandate. Thus for the company above where the vote against was only 3.5% of the total, it is worth noting that these votes accounted for 77% of the public-shareholder vote on this resolution.

It is also significant that several major listed companies in Hong Kong are taking the initiative to voluntarily lower the mandates they request from shareholders. Both Hang Seng Bank and Johnson Electric have reduced their cash mandate to 5%², while CLP Holdings has reduced its to 10% and the Bank of China (Hong Kong) gave an undertaking at its AGM this year not to exceed 10%. A number of smaller listed companies in Hong Kong have also made a voluntary reduction to 5%, with some also limiting their discount to 5%.

¹ Based on an analysis of 26 HSI companies for which voting results were available. Companies that have already reduced their cash mandate to 5% were also excluded (ie, HSBC, Hang Seng & Johnson Electric).

² Note: Hang Seng Bank follows HSBC practice, which is to ask shareholders for a 20% mandate but to limit the issuance of new shares for cash to no more than 5% of issued share capital (ie, the balance could include new shares issued in an acquisition).



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We believe that HKEx could play an important leadership role on this issue in Hong Kong and we look forward to your positive decision on this matter.

Yours truly,

A handwritten signature in black ink, appearing to read 'JA', is written over a light blue horizontal line.

Jamie Allen
Secretary General

cc:

- Ambassador Linda Tsao Yang, Chair, ACGA
- ACGA Investor Discussion Group

Enclosed:

- A discussion on the background to the UK guidelines and some recent developments.
- ACGA letter to HKEx, May 14, 2004



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Addendum:

Background to UK guidelines and recent developments

In the UK, pre-emption rights for shareholders are enshrined in law (Sections 89-96 of the 1985 Companies Act). This follows the requirements of the European Union's 2nd Company Law Directive, which was adopted in 1976 and states that if a public company is intending to issue new shares for cash, it must first offer those shares to its existing shareholders unless they have previously agreed to waive their rights. Public companies in the UK wishing to seek such a waiver from their shareholders must put forward a resolution at their AGM to "disapply pre-emption rights". This is a special resolution requiring a vote in favour of 75%.

The current UK guidelines on pre-emption rights were drawn up in 1987 by the Pre-Emption Group, a diverse body of listed issuers, institutional investors and corporate finance practitioners. The Group was instigated by the Association of British Insurers and the National Association of Pension Funds, and officially formed under the auspices of the London Stock Exchange. (For more background information, go to the website of the Institutional Voting Information Service—www.ivis.co.uk—and click on "Guidelines". IVIS is a service operated by the Association of British Insurers: www.abi.org.uk).

The guidelines have worked well in the UK and have had broad market support. However, in a November 2003 report, the Bioscience Innovation and Growth Team (BIGT), an advisory group set up by the UK Government to formulate a "strategic approach to the future of the bioscience industry"³, argued that the pre-emption guidelines were constraining the capital-raising abilities of the biotech industry in the UK and recommended that bioscience companies with a market cap of less than £1 billion be allowed to issue new shares up to 20% of issued share capital in any three-year period without pre-emption rights applying. BIGT believes this would help address an apparent funding crisis in the industry.

The UK Government responded by saying (in May 2004):

The issue of possible changes to the pre-emption guidelines is primarily one for companies and their shareholders. There is only limited backing for change from other sectors (mainly electronics). To secure the support of shareholders for any changes to the pre-emption

³ UK Government, Department of Trade and Industry press release, October 8, 2004.



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guidelines—either generally or for specific industry sectors—would require more evidence of the benefits to shareholders of allowing greater financial flexibility.

The Government will continue to look for ways forward with the BioIndustry Association and representatives of institutional investors.⁴

In September 2004, the UK Department of Trade and Industry (DTI) announced a study into the issue and appointed Paul Myners, Chairman of Marks & Spencer Group plc, to lead it. The following month the DTI announced the membership of an advisory group to work with Mr Myners. It comprises a diverse range of members from the biotech, listed issuer, institutional investment, corporate finance, legal and academic fields. The group is consulting the market and plans to release its report by the end of January 2005.

While it is not possible at this stage to foresee the outcome of the study, it is worth noting that BIGT's recommendation is a response to a specific problem in the biotech industry in the UK in recent years (ie, the difficulty of raising new funds). It should also be noted that its suggestion for the limit on non pre-emptive equity issues to be raised to a cumulative 20% in any three-year period, while comparatively generous by UK standards, remains considerably tighter than the norm in Hong Kong. Aggregating the general mandates that most Hong Kong companies request each year at their AGM produces a minimum of 60% over any three-year period, increasing to 90% if the additional 10% rule on repurchased shares is included.⁵ In fact, the number could theoretically be higher, since companies are permitted to refresh their general mandates before their next AGM if they secure the approval of independent shareholders.

⁴ UK Government Response to "Bioscience 2015" (the report of BIGT), page 10.

⁵ The total number of securities issued under a general mandate can be extended by the inclusion of shares repurchased by an issuer—"up to a maximum number equivalent to 10% of the existing issued share capital of the issuer" and "provided that the existing shareholders of the issuer have by a separate ordinary resolution in general meeting given a general mandate to the directors of the issuer to add such repurchased securities to the 20% general mandate". Rule 13.36 (2) (b), Listing Rules (Main Board), The Stock Exchange of Hong Kong.