

Corporate Communications Department
Hong Kong Exchanges & Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

By email (response@hkex.com.hk)

4 August 2017

Dear Sirs,

Re: New Board Concept Paper

By way of Introduction, Hermes is an asset manager in the City of London that focuses on long-term value creation. We are 100%-owned by one of the largest pension funds in the UK, the BT Pension Scheme. Our stewardship service Hermes EOS promotes stewardship and good corporate governance practices. Its aim is to help investors deliver excellent and long-term investment performance responsibly. As of 30 June 2017, the assets under advice of Hermes EOS stood at \$403.5 billion.

Hermes EOS welcomes your initiative to review the listing regime. As a representative of institutional investors which engages with companies globally to improve their governance practices, we understand well the competitive pressures facing stock exchanges and arguments on both sides for and against non-standard governance features, including dual-class or weighted voting rights (WVR) shares by market participants.

Our comments are based on our own experience engaging with companies on behalf of shareholders, providing you with practical insights into the implications of non-standard shareholder governance structures.

Our response is structured in four sections:

- 1) General comments
- 2) Listing opportunities for pre-profit companies
- 3) Listing opportunities for companies with non-standard governance structures
- 4) Mainland Chinese companies that seek a secondary listing in Hong Kong

General comments

In our view, the paper addresses the wrong reasons for competitiveness for an exchange. Whether an exchange is attractive as a listing platform is based on the sustained quality of its listed companies and their resulting positive attitude towards stakeholder relations and engagement. The urgent governance issues that should be addressed by the HKEx are the

quality of the issuers, shareholder concentration, related party transactions, delisting mechanisms and remedies, backdoor listings and insider trading malpractices. We believe that once these issues have been adequately addressed and clear mechanisms are in place for the protection of investors, the perception of its listed companies and therefore the competitiveness of the HKEx will improve significantly.

We do not consider the needs of new economy and early stage enterprises to be valid enough reasons for non-standard governance structures to be introduced, especially when these structures have a defining role in shaping the continued power dynamics in the boardroom and across wider corporate culture. If new economy and early-stage enterprises seek capital from investors, they have to understand the needs of the capital providers, which are shareholder protection, improved conduct, fair treatment of all shareholders and proper disclosure of related party transactions.

We oppose the suggested New Board PRO and New Board PREMIUM segments as it is not clear from the paper how a segmentation could refute following the same rationale that underpins the former concept of Growth Enterprise Market (GEM) as a stepping stone, even with a sponsor and a new prospectus. NEW Board PRO companies could still see New Board PREMIUM as the next step to attract retail capital as they become profitable or reach a certain market capitalisation.

We do not recommend different standards in governance between the New Board PRO and PREMIUM because the protection of investors should under no circumstances be compromised due to companies being in the early stages of growth. Suitable investor protection mechanisms should be put in place to address the governance risks under non-standard structures, if they were to be adopted, whether the shares are offered to professional or professional and retail investors.

More specifically, we advise against the idea of establishing a New Board PREMIUM segment which is essentially running a parallel platform to the main exchange but for large companies with weighted voting structures. We are also concerned about the arbitrary categorisation of new and old economy stocks. Most investors agree that over time only organisations and companies that continue to innovate will survive. What if companies listed on the main exchange decide to introduce non-standard governance structure. The New Board PREMIUM segment could encourage such a practice, resulting in further challenges to the established governance practices in Hong Kong. What if 'old economy' issuers transform their business models into 'new economy'? Do they become eligible to change their listing? It is not clear from the concept paper such potential consequences have been thought through in detail.

We also hold the view that segregating companies into the New Board categories still poses significant risk to institutional investors because companies with large market capitalisation are likely to be included in market indices, whether they are on the main index or not. In addition, Clause 120 refers to inclusion of Hang Seng indices, which are not common market indices used by global investors.

Listing opportunities for pre-profit companies

We acknowledge that while certain industries, such as biotechnology, could add significant value to society, they often need an extended period to reach profitability. We therefore generally agree that pre-profit companies should be eligible for listing. Financial performance is an outcome of business activities and is transient in nature. The governance structure, however, is of a different nature. Once it is in place, it can be extremely difficult if not impossible, to change.

Listing opportunities for companies with non-standard governance structures

It is often argued that WVR enable executives to resist short-term expectations from activists and protect the company from hostile takeover bids. We acknowledge that investors may benefit from a founder's value that can be significant for a growing company, including value that is realised by granting companies the ability to manage short-term investors who seek to reap gains at the expense of the long-term growth of the company. However, we do not agree that the only way to address the challenges identified is to put in place a non-standard governance structure.

Also, we consider a share price above a threshold as set out in Clause 164 to be an inappropriate quantitative criteria for measurement as this could incentivise insider trading to sustain the share price at a certain level.

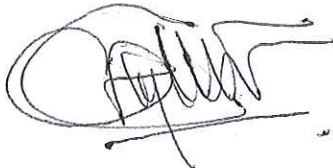
As a long-term, engaged shareholder representative, **we strongly advise against the suggested non-standard governance structure in a one track or dual-track listing regime as proposed in the paper.** The compelling reasons are detailed in a number of documents put forward by industry associations and our peers¹. In our experience, engagements with companies that have a non-standard governance structure has been particularly challenging and had limited positive outcomes. Refusals to have meaningful dialogue by the board despite the filing of shareholder resolutions and refusals to hold AGMs for an extended multi-year period as a foreign private issuer on a US exchange are only a couple of the negative examples we have come across.

Mainland Chinese companies that seek a secondary listing in Hong Kong

The proposal seem to lack real understanding of the reasons companies opt for a secondary listing. Companies seek secondary listings because they believe this can give them greater access to capital, especially in new strategic markets. The Hong Kong listings of Prada and Samsonite as quoted in the paper are primary examples of these. Some exchanges also have a higher concentration of particular sectors or industries with a wider pool of professional investors, which are the main reasons that attracted some Mainland Chinese companies to list in the US in the first place.

We are grateful for the opportunity to be able to provide our views on this important subject, which relates to the New Board proposal. Please do not hesitate to contact us if you have any questions. Thank you.

Yours Sincerely,



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¹ Some examples are: E. Unayants-Jackson (2017) The Myth of Differential Share Ownership *ICGN Yearbook* 2017: 38-39. ACGA (2017) ACGA submission on SGX consultation: http://www.acga-asia.org/upload/files/20170411_ACGA_Submission_SGX_DCS_Consultation_Final.pdf