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**Note on Exchange's Concept Paper on Weighted Voting Rights**

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## Hong Kong Stock Exchange Publishes Concept Paper on Weighted Voting Rights

The Stock Exchange of Hong Kong (the **Exchange**) has published a [Concept Paper on Weighted Voting Rights \(Concept Paper\)](#) seeking views on whether companies with governance structures giving certain persons voting power or other related rights disproportionate to their shareholdings (**weighted voting right or WVR structures**), should be allowed to list on the Exchange's markets.

Published on 29 August 2014, the Concept Paper comes as Chinese e-commerce behemoth, Alibaba Group, celebrates its record-breaking IPO on the New York Stock Exchange (the **NYSE**): raising US\$ 25 billion, the IPO turned down by Hong Kong's Stock Exchange, ranks as the world's biggest IPO ever. The Hong Kong Exchange has long been the international market of choice for listing Mainland Chinese companies, and it was in fact the initial front-runner for the Alibaba IPO. However, it refused the group's IPO on the Exchange's Main Board because the group's structure gives a group of founding shareholders the right to appoint a majority of the company's board, which would have contravened the Exchange's "one-share-one-vote" principle.

WVR structures are however allowed in the United States, where companies using them account for approximately 14% by market capitalisation of all large cap companies<sup>1</sup> and include Google, Facebook, Visa and Mastercard. Hong Kong has long been the leading international financial centre for listing and trading Mainland Chinese companies which account for 57% of the Exchange's total market capitalisation and 70% of equity turnover.<sup>2</sup> However, Mainland Chinese companies are increasingly opting for a US listing (on NYSE or NASDAQ): as at 31 May 2014, 102 Mainland Chinese companies were primary listed in the US. Around 29% of those companies have a WVR structure and together, they account for 70% of the market capitalisation of all US-listed Mainland Chinese companies. 70% of the US-listed companies with WVR structures are information technology companies. As a result, some of China's most competitive and popular companies are part of the NASDAQ Composite, but are not in either the MSCI China or Hang Seng China Enterprises indexes, two of the most commonly tracked benchmarks of Mainland China stocks. In contrast, information technology companies make up only 7% of the total market capitalisation of all Hong Kong listed companies. Only two information technology companies (Tencent Holdings Limited and Lenovo Group Limited) are included in the 50 constituents of the Hang Seng Index. The largest industries by market capitalisation on the Exchange are financials and properties and construction.

The Concept Paper states that the Exchange is neither for nor against WVR. Its intention in publishing the Concept Paper is to set out the relevant issues and considerations in a neutral, factual and analytical manner in order to promote a focused discussion on whether companies with WVR should be allowed to list. If responses to the Concept Paper show support for listing companies with WVR structures, the Exchange will publish conclusions explaining the reasons given and would then conduct a further formal consultation on the details of the scope and language of the necessary Listing Rule amendments. Responses to the Concept Paper should be made by submitting the completed [Questionnaire on Weighted Voting Rights](#) to the Exchange on or before **30 November 2014**.

The following provides a summary of the issues raised in the Concept Paper.

### 1. Current Hong Kong Position

#### 1.1 Current Rules and Principles

The fair and equal treatment of all shareholders is a fundamental principle of Hong Kong's Listing Rules. Main Board Rule 2.03(4) (GEM Rule 2.06(4)) provides that: "*The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:- .... All holders of listed securities are treated fairly and equally*".

Companies are prohibited from listing if the voting power attached to their shares does not bear a reasonable relationship to the equity interest of those shares. The prohibition also applies after listing. As a result, companies with multiple voting shares, inferior par value shares and non-voting ordinary

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<sup>1</sup> US headquartered companies primary listed on NYSE or NASDAQ with a market capitalisation greater than US\$2 billion.

<sup>2</sup> HKEx data as at the end of July 2014.

shares cannot be listed in Hong Kong. The prohibition is set out in Main Board Rule 8.11 (GEM Rule 11.25) which states that:

*“the share capital of a new applicant must not include shares of which the proposed voting power does not bear a reasonable relationship to the equity interest of such shares when fully paid (“B Shares”). The Exchange will not be prepared to list any new B Shares issued by a listed issuer nor to allow any new B Shares to be issued by a listed issuer (whether or not listing for such shares is to be sought on the Exchange or any other stock exchange) except:*

*(1) in exceptional circumstances agreed with the Exchange; or ...”*

Although this Listing Rule refers to “voting power”, the Exchange states in the Concept Paper<sup>3</sup> that it interprets the Rule as prohibiting all WVR structures, including those that give enhanced or exclusive director election rights. The Rule would thus disqualify from listing eligibility a company which achieved the same effect by embedding such rights in the company’s articles rather than by creating two classes of shares.

## 1.2 Genesis of the Prohibition on WVR Structures

Listing Rule 8.11 was introduced in 1989 in response to a 3.7% fall in the Hang Seng Index in March 1987, which was triggered by announcements by three listed companies of their intention to offer B shares via bonus issues. As part of fund raising exercises in the 1970s, the companies had issued B shares which had equal voting power to the companies’ existing A shares, but had a lower par value, and thus a lower dividend entitlement, than the A shares. B shares were typically entitled to either a fifth or a tenth of A share dividends and thus traded at lower prices. The B share issuers claimed that the issues were intended to fund real estate purchases and business expansions.

After the fall in the Hang Seng, the Standing Committee on Company Law Reform published a report on WVR structures in July 1987. The report concluded that the reason for issuing B shares was to allow companies controlled by founding families or entrepreneurs to retain control, while still being able to raise equity finance. They also provided an inexpensive way for controllers to purchase voting power and consolidate control, since they carried one vote per share but traded at a discount to A shares because of their lower dividend entitlement. The Standing Committee report also noted that in the context of Hong Kong’s 1997 return to Chinese sovereignty, B shares enabled a majority owner to transfer substantial portions of its capital overseas while maintaining actual control in Hong Kong. This could be achieved by a majority shareholder selling A shares, and at the same time purchasing B shares in equal proportion. The Standing Committee feared that the practice could lead to “a lessening of confidence in Hong Kong as a major financial centre” which was why it opposed the indiscriminate issue of B shares.

Nevertheless, the Standing Committee considered that there remained a legitimate need for the continuing availability of B shares *in exceptional circumstances*. Examples of such “exceptional circumstances” stated in the report included where “*national security or the interests of the community as a whole ...may make it desirable that ultimate control should be concentrated in particular hands, although there is support for the view that the use of B shares for these purposes is normally only acceptable when a company first applies for a listing and there is no question of protection for minority shareholders*”.<sup>4</sup> As a result, Listing Rule 8.11 was introduced to prohibit the listing of companies where voting power and equity interest are not aligned, but allows the Exchange to approve the listing of such companies on a case-by-case basis in exceptional circumstances. The Exchange has not permitted any company to list in reliance on the exception to date.

## 2. Competitive Position

As mentioned above, Hong Kong is the leading international market for the listing and trading of Mainland Chinese companies. The Concept Paper notes that the ability to attract a broad spectrum of Mainland companies to list on the Exchange could be an important factor in ensuring Hong Kong’s

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<sup>3</sup> Concept Paper at paragraph 82.

<sup>4</sup> The Third Interim Report of the Standing Committee on Company Law Reform: B Shares (July 1987) at paragraphs 8 and 12. An extract from that report (including the relevant paragraphs) is included in the Concept Paper at Appendix 1.

continued relevance as China opens up its financial markets. So far, Mainland companies using WVR structures have chosen to list in the United States. The majority of these are information technology companies and include JD.com and Alibaba Group. The US exchanges, the NYSE and NASDAQ, allow the listing of companies with WVR structures, although this is in the context of a different legal and regulatory regime to Hong Kong's, which is discussed further below. The Concept Paper also notes that Hong Kong is ranked third in the area of investor protection in the "Doing Business 2014" measure of business regulations published by the World Bank and International Finance Corporation. The United States is ranked sixth for investor protection.

In June 2014, the Financial Services Development Council's (FSDC) published a paper entitled "Positioning Hong Kong as an International IPO Centre of Choice" which comments that Hong Kong risks over-reliance on Mainland China as the source of its IPO candidates and recommends making "every effort to diversify its 'client base' and actively open up to quality companies from all corners of the world".<sup>5</sup> The Concept Paper also points to the implementation of the Shanghai-Hong Kong Stock Connect pilot programme, which is scheduled for October 2014, as a development which could have a fundamental impact on Hong Kong's attractiveness as a listing venue for overseas companies. The Exchange has stated that the programme is scalable in size, scope and market in the future and that cross-border capital raising may eventually be permitted under the programme, subject to SFC and CSRC regulatory approvals. The ability to list on the Exchange with a WVR structure might therefore prove attractive both to companies with WVR structures which are already listed on other exchanges, and to privately-owned overseas companies with such structures looking for their first public listing.

The FSDC's paper also comments that the "one share one vote" principle embodied in Rule 8.11 merits more detailed study and re-consideration with the benefit of a public consultation. Pointing to the fact that Rule 8.11 may have deterred the Hong Kong listing of overseas companies with genuine commercial or legal reasons for having WVR structures (e.g. a legitimate desire to raise funds without diluting control), the Concept Paper urges the Government and regulators to review the rule and consider whether modifications or partial relaxations are appropriate.

### 3. Empirical Studies and WVR Pros and Cons

#### 3.1 Arguments against WVR Structures

The Exchange summarises the arguments against WVR structures as follows:

##### a. *Proportionality*

Company shareholders normally have one vote for every ordinary share held. This is because, by buying additional shares, they put more of their own capital at risk and are therefore entitled to a greater proportion of the company's future cash flows. The gain of an additional vote for each share purchased ensures that shareholders have a greater say in who manages the company for the purpose of producing future capital gains and cash flows. They also gain a proportionate say on whether cash flows will be paid out as dividends. The one share one vote principle thus ensures that shareholders with the same interest are given an equal say on matters affecting the value of their shares.

##### b. *Empirical Evidence*

The Exchange conducted an in-depth review of the empirical academic studies that have been carried out on the effect of a dual-class share structure or DCS, which are summarised at Appendix IV to the Concept Paper. The consensus view is that investors generally apply a discount to shares with inferior voting rights in a dual-class share structure, which the studies argue reflects the following risks:

- ***Controllers' consumption of private benefits*** – it is argued that a dual-class share structure that allows controlling shareholders to retain control while holding a relatively small equity stake in a company makes it more likely that the controlling shareholders will extract personal benefits from

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<sup>5</sup> FSDC paper "Positioning Hong Kong as an International IPO Centre of Choice", "Section 5 Conclusion", page 60.

the company (e.g. excessive salaries or perks). This is because they can enjoy the full benefits they take out of the company, but suffer less downside through the reduction in the value of their equity stake in the company resulting from their extraction of private benefits;

- It is also considered that a smaller equity interest could incentivise controlling shareholders to transfer quality assets out of a listed company to other companies in which they have a greater stake, and vice versa (which is known as “tunneling” or “value shifting”); and
- **Entrenchment risk** –day-to-day decision making is typically delegated to a company’s board of directors, while shareholders’ approval is required only for the most important matters, such as the appointment and removal of directors. Theoretically, the knowledge that they can be removed by shareholders should motivate directors to perform well and act in the best interests of the company as a whole. Where however a company has a WVR structure, the non-controlling owners may be prevented from removing directors who extract private benefits, fail to manage the business so as to maximise its value and performance or act contrary to the wishes of the minority shareholders.

### 3.2 Arguments in favour of WVR Structures

Arguments put forward in support of allowing WVR structures include the following:

- a. **Long-termism** - A WVR structure may promote long-termism as it gives incumbent directors the freedom to run a business in order to maximise growth and value for shareholders over the long term. While entrenchment is detrimental for investors if a company performs badly due to poor management, it can also benefit a company since it insulates the directors from shareholder pressure to generate short term returns that are not in the company’s long term interests;
- b. **Detrimental market impact** – the prohibition on WVR structures restricts investors’ ability to invest in companies using the structure, and thus renders the Exchange a less efficient marketplace for achieving the effective allocation of capital from investors to listed companies. In addition, controlling shareholders are prevented from diversifying their wealth into other entrepreneurial projects which could benefit the market as a whole; and
- c. **Allow financing without dilution** – Fast growing companies looking to list on the Exchange may already have had one or more rounds of private equity or debt financing and exhausted their ability to grow through private investment. The founders will have diluted their stake in the company as a result. A WVR structure would allow the company to expand without diluting the founders’ ownership any further and to maintain management continuity.

### 3.3 Impact of WVR Structures

While investors typically apply a discount to shares with inferior voting rights to reflect the risks of consumption of private benefits, underperformance and management entrenchment, the Concept Paper concludes that there is a lack of consensus as to whether those risks in fact have a negative impact on a company’s performance. The Concept Paper also notes that some studies provide evidence that laws and regulations can limit the negative impact of WVR structures.

## 4. Jurisdictional Comparison

The results of the Exchange’s review of the rules and practices in other jurisdictions are set out in Appendix 3 to the Concept Paper. A range of approaches to WVR are adopted which fall into three main groups:

- Some jurisdictions allow WVR structures under both their corporate law and listing rules (e.g. the US, Canada and Sweden);
- Other jurisdictions allow companies to have WVR structures under their company law, but prohibit such companies from listing (e.g. Hong Kong, the UK, Australia and Singapore);



- Some prohibit both listed and unlisted companies from using WVR structures (e.g. Germany, Spain and Mainland China).

In terms of competition for listing Mainland Chinese companies, after the US, the Exchange principally competes with Singapore and the UK. The Singapore Stock Exchange (SGX) does not allow primary listed companies to have WVR structures. The UK prohibits the listing of “premium listed” shares with mechanisms designed to consolidate power in the hands of a small number of individuals. WVR structures are allowed for “standard listed” shares, but institutional shareholders in the UK are generally hostile to these structures. As at the end of May 2014, 57 Mainland Chinese companies were primary listed on the SGX, but there have been no new listings of Mainland Chinese companies since 2012. Eleven Mainland Chinese companies are listed on the London Stock Exchange. However these are all listed on AIM, the London Stock Exchange’s market for smaller growth companies. None of these companies have WVR structures.

## 5. **Alternative WVR Structures**

The Exchange’s review found that dual class shares are the most common type of WVR structure in the US. These structures often give incumbent controllers either enhanced or exclusive rights to elect directors (usually a majority) to the company’s board. It also found that it is possible for Mainland Chinese companies to list in the US with alternative WVR structures and the Concept Paper seeks views on whether these alternative structures should be considered for companies seeking to list in Hong Kong. The principal types of alternative structures identified are:

### a. ***Dual-class director election***

A survey showed that 45 companies (3%) in the S&P 1500 Composite Index<sup>6</sup> were controlled through shares allowing the holders to elect a fixed number or percentage (usually a majority) of board members. The boards of 21 of these companies are split into two groups, each of which is associated with a share class: i.e. “Class A” directors and “Class B” directors. Directors are elected at general meetings where Class A shareholders elect the Class A directors and Class B directors are voted for by the Class B shareholders. One class of shareholders, typically the company’s founders, will have the right to nominate a larger number of directors to the board than the other class. Companies using this structure include Nike Inc and the New York Times Company.

### b. ***Non-voting ordinary shares***

These companies have classes of non-voting ordinary shares and a separate class of shares carrying one vote per share, which are normally held by insiders. As a result, outside investors have little say in the major decisions made by the company. Companies listed in the US with non-voting ordinary shares include Apollo Group Incorporated and Federated Investors Inc.

### c. ***Hybrids***

Some companies have issued shares entitling holders to both multiple votes per share and the exclusive right to elect a majority of the board. Companies with such shares include Expedia Inc., the Hershey Company and the Ralph Lauren Corporation.

### d. ***Special control rights granted in Articles***

It is also possible for a company to list in the US using a WVR structure that gives special control rights to particular persons through provisions in the articles only; the rights do not therefore attach to any particular class of shares. For example, the articles of Autohome, Inc., a Mainland Chinese online automobile sales company listed on NYSE in December 2013, state that while the company’s current controlling shareholders hold at least 39.3% of its total ordinary share capital, they are entitled, but not obligated, to appoint at least a majority of the directors to its board. They also have special rights to fill a vacancy following the removal of a director they appointed. Directors appointed by a controlling shareholder are not subject to retirement by rotation.

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<sup>6</sup> as at 1 January 2012.

In the case of JD.com, a Mainland Chinese online direct sales company listed on NASDAQ, the articles state that the quorum for a board meeting of the company is not achieved unless the founder is present. The founder has a casting vote where directors cast an equal number of votes in favour or against a particular issue and he must approve any appointment of a director to fill a casual vacancy. JD.com also has a dual-class share structure: the “B” shares held by the founder entitle him to 20 votes per share.

LightInTheBox Holding Company Ltd, a Mainland Chinese online retailer listed on the NYSE, has a single class shareholder structure that entitles shareholders to one vote per share on most shareholder resolutions. However, the company’s articles provide that its founders have three votes per share on any resolution concerning a change in control of the company.

Alibaba Group Holding Limited has a single class of ordinary shares which entitle holders to one vote per share on all matters on which ordinary shareholders are entitled to vote. However, the Alibaba Partnership has the exclusive right to nominate a simple majority of the directors on the board. The election of each director nominee is subject to majority approval of the company’s shareholders at the company’s annual general meeting.

## **6. Additional Considerations**

The following additional issues are raised for consideration in the Concept Paper’s Chapter 6.

### **6.1 Possible Restriction to New Listing Applicants**

In its 1987 report on dual-class share structures, the Standing Committee on Company Law Reform stated that such structures should only be allowed when companies apply to list on the Exchange. Investors in such companies would acquire shares in full knowledge of the fact that their shares carry rights which are inferior to those carried by the shares held by the company’s controllers. As they have no existing stake in the company, there is no question of their existing rights being reduced by the adoption of a WVR structure at IPO. On the other hand, if the implementation of a WVR structure in favour of the controlling shareholder(s) were permitted post listing, this risks limiting the rights of the company’s minority shareholders.

In the US, the NYSE and NASDAQ allow new listing applicants to list with WVR structures. Any listing of shares on such markets that may prejudice the interests of the existing shareholders of the company is however prohibited.

The NYSE Listed Company Manual provides that the voting rights of existing shareholders of publicly traded common stock registered under section 12 of the Exchange Act cannot be disparately reduced or restricted through any corporate action or issue. Non-exhaustive examples of such corporate action or issue are stated to include: the adoption of time phased voting plans, the adoption of capped voting rights plans, the issue of super voting stock, or the issue of stock with voting rights less than the per share voting rights of the existing common stock through an exchange offer.<sup>7</sup>

NASDAQ’s Stock Market Rules also prohibit a company from creating a new class of security that votes at a higher rate than an existing class of securities, or from taking any other action that has the effect of restricting or reducing the voting rights of an existing class of securities.

### **6.2 Circumvention Risk**

The Concept Paper raises the concern that a restriction that would permit only new listing applicants to adopt a WVR structure, could lead to existing listed companies seeking to circumvent the restrictions. Means of circumventing the restriction include: transferring assets/businesses to a private company and subsequently listing the private company with a WVR structure; spinning off assets or businesses as new listed companies with WVR structures or conducting reverse takeovers with such structures; or de-listing in order to re-list as a company with a WVR structure.

The Concept Paper raises the possibility of the Exchange adding general anti-avoidance provisions to the Listing Rules to prevent existing listed companies from circumventing the restriction. Drawbacks

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<sup>7</sup> NYSE Listed Company Manual, Rule 313(A).

highlighted are that the anti-avoidance provisions may not always succeed, and that the decision as to whether a particular transaction constitutes an attempt to circumvent the restriction will be a subjective one in each case.

### 6.3 Restrictions in Use on US Markets

The Concept Paper notes that US listed companies generally impose restrictions on WVR structures voluntarily. For example, multiple voting shares must normally convert to ordinary shares that entitle the holder to one vote for each share held on all matters subject to shareholder approval at general meeting (**OSOV shares**) on a transfer of beneficial ownership to a person that is not affiliated with the original holder. Other companies require holders of multiple voting shares to maintain beneficial ownership of a specified percentage of the company’s share capital. One US listed company, Groupon, has a five year sunset clause after which its dual-class share structure terminates. The Concept Paper welcomes comments on whether these or other restrictions should be imposed on WVR structures if companies using them are to be allowed to list in Hong Kong.

The table below summarises the restrictions on the rights of holders of shares with multiple voting rights in US listed companies.

Characteristic	Description of Restriction	Prevalence in Mainland Chinese Companies	Non-Chinese Examples
	<p>Multiple voting shares must convert into OSOV shares if beneficial ownership is transferred to persons who are not “affiliated” with the original holders.<sup>8</sup></p> <p>Three companies (China Dangdang, Qihoo 360, and Qunar Cayman) also require conversion if an “affiliate” transfers the shares within six months of gaining beneficial ownership.</p> <p>One company (Mindray Medical) requires conversion if an “affiliate” transfers the shares at any time after gaining beneficial ownership.</p>	<p>27 of 30 companies (all except Shanda Games, eLong and LightInTheBox)</p>	<p>Facebook, Google, LinkedIn, Zynga</p>
Minimum equity threshold held by founders or others	<p>If at any time the founders of the company hold less than 5% of the multiple voting shares, all multiple voting shares in issue must convert into OSOV shares.</p> <p>One company (Autohome) sets this threshold at 39.3% of the sum of both classes of its shares and</p>	<p>13 of 30 companies (58.com, Autohome, Baidu, China Dangdang, iKang Healthcare, JD.com, Jumei International, NQ Mobile, Perfect World, RenRen,</p>	<p>AMC Entertainment Holdings, Inc (30% of all outstanding shares threshold)</p>

<sup>8</sup> “Affiliated persons” normally means: (a) the holder’s immediate family, a trust established for their benefit and companies wholly or partially owned by those family members; and (b) companies controlled by the holder.

<b>Characteristic</b>	<b>Description of Restriction</b>	<b>Prevalence in Mainland Chinese Companies</b>	<b>Non-Chinese Examples</b>
	<p>another (RenRen) sets it at 50% of the founders' total holding of both its share classes at IPO. iKang Healthcare sets this threshold at 8% of the company's total issued common stock. JD.com requires conversion of its B shares if its founder does not hold any.</p> <p>Two companies, in addition to the founder threshold above, require conversion of multiple voting shares if the holding of any non-founder changes by more than 50% (NQ Mobile and YY Inc). RenRen requires conversion if non-founders' total ordinary shareholding at IPO falls below 50%.</p>	TAL Education, Weibo and YY)	
Change of control event	One company (Autohome) requires conversion of all multiple-voting shares into OSOV shares if there is a change in control of the company.	One of 30 companies (Autohome)	No example found
Retirement / incapacity / death of founder	<p>One company (JD.com) requires conversion of all multiple voting shares into OSOV shares if the founder is no longer employed as the chief executive officer or cannot permanently attend board meetings due to his physical and/or mental condition.</p>	One of 30 companies (JD.com Holdings)	Google, <sup>9</sup> Zynga, LinkedIn, Groupon
Minimum threshold of shares outstanding	One company (Mindray Medical) requires conversion of its multiple voting shares into OSOV shares if the number of those shares outstanding falls below 20% of total share capital.	One of 30 companies (Mindray Medical)	LinkedIn, Zynga (conversion below minimum 10% of share capital threshold)
Vote of shareholders	A requirement for the conversion	None	Facebook

<sup>9</sup> Unless the multiple-voting shares are transferred to another founder or to a trustee nominated by the founder prior to his death and approved by the board of directors (see Google, Inc certificate of incorporation, exhibit 3.01.2 to Form S-1/A filed on 9 August 2004, Article IV, Section 2(f)(iv)). Groupon has a similar provision in its certificate of incorporation (see Groupon, Inc certificate of incorporation, exhibit 3.2 to Form S-1/A filed on 1 November 2011, Article IV, Section 4(f)).

Characteristic	Description of Restriction	Prevalence in Mainland Chinese Companies	Non-Chinese Examples
	of all multiple voting shares into OSOV shares if holders of multiple voting shares vote for it.		(approval by majority of multiple voting shareholders)  Groupon (approval by 66.6% of multiple voting shareholders)
Sunset clause	A requirement for the conversion of multiple voting shares into OSOV shares at a particular future date.	None	Groupon (conversion into OSOV shares after five years <sup>10</sup> )

#### 6.4 Possible Additional Restrictions for Hong Kong Listed Shares with WVR Structures

Additional restrictions that the Exchange raises for consideration include:

- a. a requirement for warnings in all corporate communications;
- b. an “X” in their short stock names;
- c. a cap on the number of votes that can be carried by one share;
- d. enhancing the powers of independent non-executive directors; and
- e. additional circumstances that may require a company to unwind its WVR structure at either a shareholder or board level.

#### 6.5 Possible Restriction to GEM Board or a Professionals Only Board

There have been suggestions that companies with WVR structures should be allowed to list on the Exchange’s Growth Enterprise Market (**GEM**). However, the GEM Listing Rules contain the same restriction on listing a company with multiple classes of shares with unequal voting power and amendments to those Rules would be required to allow the listing of WVR structure companies.

Another possibility raised is that companies with WVR structures could be allowed to list only on a newly-created board to which only professional investors would have access. This would however set the Hong Kong Exchange apart from other markets as there are no other markets which restrict the trading of ordinary equity securities to professional investors.

The Concept Paper notes that the Shanghai Stock Exchange has announced plans to launch a new board for “strategic emerging industries”, although would not permit the listing of companies with WVR structures.<sup>11</sup> The proposal has been submitted for approval which is still pending.

While the Concept Paper does not address the more general question of the re-positioning of GEM or the creation of a professional (or other) board for listing companies with WVR

<sup>10</sup> Groupon’s two classes of common stock will automatically convert into a single class of common stock on 9 November 2016, five years after the filing of their sixth amended and re-stated certificate of incorporation with the State of Delaware (Sources: Groupon, Inc, certificate of incorporation, exhibit 3.2 to Form S-1/A, filed on 1 November 2011, Article IV, Section 4(a)(iii) “Final Conversion Date” and (d) “Final Conversion of Class A Common Stock and Class B Common Stock”; and 2013 Proxy Statement (Form DEF 14A), filed on 29 April 2013, Note 1 to “Information Regarding Beneficial Ownership of Principal Shareholders, Directors and Management”).

<sup>11</sup> Announced by the CSRC on 7 March 2014.

structures, the Exchange will take into account any views from the market submitted in response to the Concept Paper on the acceptability or desirability of using GEM, a professional board, or another separate board focused on, for example, specific sectors or companies with specified characteristics.

#### **6.6 Secondary Listing of Greater China Entities**

The Concept Paper refers to the public debate on the acceptability of a secondary listing on the Exchange for Chinese companies with WVR structures that are already listed on US exchanges. According to the revised Joint Policy Statement for Overseas Companies issued by the Exchange and the SFC in September 2013, the Exchange will *not* approve an application for secondary listing by a company that has its “centre of gravity” in Greater China. This reflects the Exchange’s longstanding policy that the Exchange is the natural market for listings of Mainland and Hong Kong companies.

Unless this policy is changed, a US listed Chinese company can only apply for a dual primary listing on the Exchange and a secondary listing is not possible. The Exchange intends to review whether Chinese companies should be allowed to secondary list in Hong Kong at some point in the future.

#### **6.7 Possible Restriction to Companies in Particular Industries**

The US stock exchanges present the most competition to the Hong Kong Exchange in terms of listing Mainland Chinese companies. This is particularly true for information technology companies which account for 70% of the Mainland Chinese companies listing in the US with WVR structures and 90% of those companies by market capitalisation. In contrast, only two information technology companies (Tencent Holdings Limited and Lenovo Group Limited) are included in the 50 constituents of the Hang Seng Index.

To stave off competition from the US, while limiting the risks posed by dual-class share structures, it is suggested that the use of such structures should be allowed only for companies in particular industries, such as information technology companies. This would however make the Exchange the only major stock exchange to restrict the use of WVR structures to companies in a particular industry.

The Concept Paper also notes that while WVR structures are particularly prevalent in the information technology industry, they are also adopted by companies in a wide range of other industries. 80% of US IPOs by companies with dual-class share structures were of non-information technology companies in the period from 2001 to the end of 2013. While IPOs of information technology companies are the main area in which the Exchange currently competes with the US exchanges, that may change in the future, raising the question of whether it is sensible to restrict WVR use to information technology companies now.

#### **6.8 Classification Issues**

One difficulty with restricting WVR structures to information technology companies is how these companies would be defined. Basing a definition on the Hang Seng Industry Classification (HSIC) System risks excluding certain types of company that in layman’s terms might be considered to be “technology” companies, for example bio-technology and clean energy companies. This definition also excludes companies in the telecommunications industry.

#### **6.9 Possible Restriction to “Innovative Companies”**

An alternative suggestion is to permit “innovative” companies only to use WVR structures. The aim would be to allow the listing of exceptional companies likely to have a transformative effect on their industry or society in general. It’s thought that in time, such companies could prove beneficial to the market and society as a whole. The decision as to whether a company is

“innovative” would however be highly subjective and poses the further problem that a company that starts out as “innovative” will quickly become commonplace raising the question of whether it should have to abandon its WVR structure at that stage.

## 7. The Consultation Questions

The consultation questions are set out in Chapter 7 of the Concept Paper and are reproduced below. Paragraph and Chapter references are to paragraphs and chapters of the Concept Paper unless stated otherwise.

**Question 1:** Should the Exchange in no circumstances allow companies to use WVR structures? Please give reasons for your views.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

**Question 2:** Should the Exchange permit WVR structures:

- (a) for all companies, including existing listed companies; or
- (b) only for new applicants (see paragraphs 147 to 152); or
- (c) only for:
  - i. companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162), please specify which industries and how we should define such companies;
  - ii. “innovative” companies (see paragraph 163 to 164), please specify how we should define such companies; or
  - iii. companies with other specific pre-determined characteristics (for example size or history), please specify with reasons.
- (d) only in “exceptional circumstances” as permitted by current Listing Rule 8.11 (see paragraph 81) and, if so, please give examples.

Please give reasons for your views.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

**Question 3:** If a listed company has a dual-class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views.

**Question 4:** Should other WVR structures be permissible (see Chapter 5 for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

**Question 5:** Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V)? If so, please specify these changes with reasons.

**Question 6:** Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of this paper:

- (a) using GEM, a separate board, or a professional board to list companies with WVR structures (see paragraphs 33 to 41); and
- (b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47)?

**Question 7:** Do you have any other comments or suggestions regarding WVR structures?

#### **8. Responding to the Concept Paper**

Responses to the questions raised by the Concept Paper can be made by submitting the Questionnaire which is available on the Exchange's website at <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082q.doc> on or **before 30 November 2014** either:

a. By e-mail to [response@hkex.com.hk](mailto:response@hkex.com.hk). The subject line should be marked:

**“Re: Concept Paper on Weighted Voting Rights”.**

b. By mail or by hand to:

Corporate Communications Department  
Hong Kong Exchanges and Clearing Limited  
12<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street  
Central  
Hong Kong

**Re: Concept Paper on Weighted Voting Rights**

c. By fax to: 2524 0149.

#### **November 2014**

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