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Dear Sir/Madam

CONSULTATION PAPER

Review of the eligibility of Foreign Companies, Stapled Securities, Weighted Voting Right Companies

Legal & General Investment Management (LGIM) is one of the largest international investors with over USD 1.24 trillion of assets under management (as at 30 June 2017)[1]. We manage assets for a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

In Hong Kong, LGIM is a significant investor with over USD 6.6bn (as at 31 December 2017) of equity invested in the region both in index and active funds. Furthermore, we have a growing presence demonstrated by the recent expansion of our trading and index fund management arm in Hong Kong. Our strategic commitment is long term and aimed to provide the best solutions for our clients.

As a major user of indices, we believe it is our responsibility to ensure that global markets operate efficiently and uphold the highest level of governance standards to protect the integrity of the market over the long term. LGIM also considers the equal treatment of shareholders by allocating control of a company in proportion to economic interest is vital for a well-functioning market. Therefore, the opportunity to respond to the consultation by Hang Seng Index is very important to LGIM.

We acknowledge that the issue of weighted voting rights (WVR) has drawn similar interest from other global indices. FTSE, S&P and MSCI have all released public consultations on this related topic which LGIM, as a large user of their indices, has responded and fed back consistent views.

Our message to global indices is that we do not support proposals which will lead to perpetual control of a company being given without a corresponding level of capital at risk. The WVR framework prevents mechanisms in the market from working efficiently and investors are unable to hold board directors to account for the way they utilise shareholder funds.

[1] Including derivative positions and advisory assets. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor.

LGIM would encourage Hang Seng to safeguard the interest of investors by not including WVR Companies in its indices and upholding its high quality governance standards. We view both the regulator and indices as playing critical roles in protecting the interests of all shareholders which in turn lowers the cost of capital for issuers.

We hope you find our comments useful and if you have any questions, please do not hesitate to contact us directly.

Yours sincerely,

Sacha Sadan
Director of Corporate Governance

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Head of Index Funds, Asia
LGIM Asia

Appendix 1 – Consultation Paper Questions

Question 1 – Given that the role of the HSCI is to be a comprehensive Hong Kong market benchmark, do you think Foreign Companies should be eligible for inclusion in the HSCI?

No, we believe Foreign Companies should not be eligible for inclusion in the HSCI.

The Hong Kong market benchmark is an attractive market for our clients. We are concerned that the Hong Kong market benchmark could be re-defined if HSCI relaxes its rules to allow Foreign Companies with primary listing in Hong Kong while conducting majority of their business outside Hong Kong, Macau and mainland China.

We acknowledge that many companies change their business strategies as the market landscape is reshaped and new business opportunities arise. Foreign Companies that have established a presence in Hong Kong as part of the execution of their Greater China business strategy have formed strong relationships and demonstrated a long history of local presence with a good track record of business success.

However, some Foreign Companies have yet to display such commitments to the region. Furthermore, some companies operate on a cyclical basis and may be perceived to amend their business strategies and regional activities to navigate through these cycles.

For many key index compilers, the key factors to indicate majority business being conducted in the country of risk classification are well observed and defined.

Therefore, eligibility of Foreign Companies in to the HSCI should only be upheld if they meet the existing criteria of being incorporated in HK and conducting the majority of their business inside Hong Kong, Macau or mainland China in order to be representative of a Hong Kong market benchmark constituent.

Question 2 – Given that the role of the HSCI is to be a comprehensive Hong Kong market benchmark, do you think Stapled Securities with the existing legal structure should be eligible for inclusion in the HSCI?

LGIM does not have views on these proposals.

Question 3 - Given that WVR Companies will be listed on the Main Board of the SEHK, do you think Hang Seng Indexes should consider including such companies in the HSCI universe?

Please see Question 4.

Question 4 – Do you think additional eligibility criteria (e.g. free-float, voting rights, listing history) should be applied in the selection of WVR Companies, which have very different risk profiles to existing eligible securities, for potential inclusion in the HSCI?

LGIM does not believe that companies with WVR should be eligible for inclusion in the HSCI universe and have significant concerns with the proposal by the SEHK to allow such companies to be listed on the Main Board.

Voting rights are a fundamental characteristic of equity capital. It underpins effective investor stewardship, and is the central mechanism through which shareholders exercise their ownership rights. We support the universal 'One Share – One Vote' principle which embeds the fair and equal treatment of all shareholders by allocating control in direct proportion to the level of economic interest and exposure to risk. If allocation of control is un-even, this raises the risk of a controlling group entrenching its positions and creating a disadvantage for non-controlling shareholders. In addition, investors will be impeded from taking appropriate action against company behaviour that may be harmful to their long term interests due to the absence of equal voting rights.

We agree with Hang Seng Indexes that WVR have very different risk profiles, but do not believe these can be adequately compensated through the addition of further eligibility criteria in the HSCI. Rather we consider WVR are detrimental to the efficient functioning and integrity of the wider public market over the long-term. Furthermore, such structures also impact the cost of capital of issuers and empirical studies have shown there is no long-term benefit for public shareholder from the company being controlled.[2] This is a message we have communicated to other global indices including FTSE Russell, MSCI and S&P Dow Jones.

LGIM supports the approach taken by S&P Dow Jones which will be excluding any new companies from joining its key US indices if they have multiple share class structures including WVR, in recognition of the risks to shareholders. MSCI have also announced that it is re-opening its consultation on treatment of unequal voting rights with views to be submitted by the end of May 2018.

We strongly believe that the Hang Seng Indexes should not consider eligibility status in the HSCI for companies with WVR as they risk diluting the listing quality of the Hong Kong market as a result of sub-standard governance rules being implemented.

[2] Controlled Companies in the S&P 1500, A Follow-Up Review of Performance and Risk, IRRC Institute and ISS, March 2016