Our Ref
Your Ref
Direct Tel 020 3124 3057
Direct Fax
E-Mail david.patt@lgim.com
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One Coleman Street
London
EC2R 5AA
Tel: +44 (0)20 3124 3000

Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sir/Madam

New Board Concept Paper

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 4.1 billion 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 significant investor, there is a 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. Therefore, the opportunity to respond to the consultation by the HKEX regarding the 'New Board' is very important to LGIM.

We have decided to not respond to the individual detailed questions in the paper due to our fundamental disagreement with the concept but instead have provided below an outline of LGIM's stance on key topics and areas where we have strong views.

<u>LGIM's POSITION ON THE 'NEW BOARD'</u>

As a long-term shareholder, LGIM has significant concerns with the proposal by the HKEX to introduce a New Board (New Board PRO and New Board PREMIUM) to the market. We believe that the new proposal has not fully considered the long-term impact on investors, such as LGIM, and the consequences of a dilution in listing quality as a result of sub-standard governance rules being implemented e.g. weighted voting rights (WVR).

The HKEX has already experienced an underperforming Growth Enterprise Market (GEM), which was specifically designed to cater to higher risk companies in a different segment. This demonstrates the unintended consequences of narrow listing considerations and how lowering standards can impact market integrity.

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

As long term investors, we take our investor stewardship responsibilities very seriously on behalf of our clients. The introduction of different corporate governance and stewardship codes globally is evidence of this trend and the need to strengthen guidelines, not weaken them.

Therefore, a sound corporate governance framework is needed to support issuers, protect investors and shape a sustainable premium market. We do not support the rationale behind the development of a separate segment, with sub-standard governance standards, to compete for Initial Public Offerings (IPOs). Furthermore, the HKEX should ensure that any rules and regulations being introduced should protect the interests of public investors first and ahead of any commercial interests.

LGIM's CONCERNS

Below are the key concerns we have with the proposal:

- **Weighted Voting Rights (WVR)**

Voting rights are a fundamental characteristic of equity capital. They underpin effective investor stewardship, and are the central mechanism through which shareholders exercise their ownership rights.

We support the '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 uneven, 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. Moreover, empirical studies have shown that there is no long-term benefit for public shareholders from the company being controlled.[2]

Therefore, we are NOT supportive of weighted or unequal voting rights because they are detrimental to the efficient functioning and integrity of the wider public market over the long-term. Perpetual control of a company without a corresponding capital at risk prevents the mechanisms of the market to hold management and the board to account for their use of capital.

- **Definition of New Economy companies**

LGIM is concerned with the approach taken by the HKEX that defines "New Economy" companies. We do not believe that by removing certain measures, which protect investors and enhance the quality of companies, will assist in attracting high growth companies or additional capital to the Hong Kong market.

We are unclear with the definition of "New Economy" and the companies which will be included in this category. The HKEX has stated that no fixed definition is proposed and that the Listing Committee will retain the ultimate discretion to decide which companies are eligible.[3] The lack of transparency around the decision making process does not help investors understand how companies adhere to good standards prior to listing and whether there is a certain threshold of protection which will assess the quality of issuers coming to the market.

[2] https://irrcinstitute.org/wp-content/uploads/2016/03/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf
[3] https://www.hkex.com.hk/eng/newsconsul/hkexnews/2017/Documents/1706163news.pdf, page 8

LGIM also does not consider that the current standards hinder high growth companies from coming to the market. In fact, high growth companies should be embracing these rules as they are designed to provide a stronger framework for business, protecting both the issuer and shareholders. Furthermore, there are plenty of examples of thriving companies already listed in global exchanges from the targeted sectors identified by the HKEX in the New Economy.

Innovation is a business concept built into all companies and every new generation witnesses new economies and sectors developing. We do not see any investment benefit from re-classifying these companies because businesses and markets are constantly evolving.

Therefore, we fail to understand why rules should be weakened in the New Board and would strongly advocate that standards are upheld to protect all participants in the market.

- **Pre-profit companies**

As a sophisticated investor who understands and can analyse the risk/return profiles of companies, LGIM does not have any significant concerns with the inclusion of pre-profit companies in the current listing framework. Equity is an important source of capital for financing growth to create future profitable companies and the effective facilitation of this capital transfer is a key feature of a sustainable financial market.

On the other hand, less-sophisticated shareholders may not be able to make this assessment if they do not have the sufficient analytical capabilities or risk management tools e.g. retail shareholders. This means, in the absence of being able to understand and interpret company information, retail shareholders will be more exposed to the risks pertaining from pre-profit companies continuing to operate and aspiring to become a going concern.

Therefore, less sophisticated investors need greater awareness of how the risk/reward profile of the company changes by not making a profit. *Caveat emptor* (buyer beware) principles need to be in place with appropriate boundaries to isolate and protect the public interest.

- **Unintended consequences and impact on Main Board**

It is important that the HKEX understands the consequences of its decisions around amending its rules and the impact this will have on the quality of companies entering the market (both in terms of profitability and corporate governance). Rather than examining the issue from a short term perspective, the HKEX should seek to better understand how this will influence and shape the long-term market.

LGIM is concerned with the potential side effects developing on the Main Board as a result of less stringent governance standards being applied to other Boards on the HKEX. For example, we view that the implementation of the New Board will worsen the quality of companies to the Hong Kong market overall and that HKEX's key value proposition of being a mature and stable marketplace will erode over time.

We would like to see the continued growth of the Main Board in Hong Kong which plays a vital role as an international market for Chinese and Asian based enterprises being capable of meeting the HKEX's current governance standards.

FURTHER RECOMMENDATIONS

The HKEX highlighted in the consultation that there was a significant risk the market would be stagnant and there would be a lack of investor interest due to the low exposure to higher growth sectors.[4]

However, our view is that in order to address the issues highlighted, the HKEX needs to examine the principles needed to support the long-term development of the market and provide a strong governance foundation to attract long-term capital and good quality companies across all sectors rather than concentrate on a particular group of companies.

Below are three main areas which we believe can provide a significant improvement in raising the quality of the market and appeal to new prospective issuers because of the attraction of international investors to higher governance standards:

1. Good quality disclosure and transparency

As long-term investors, we believe that good quality disclosure is required to clearly represent the company's performance. The end goal is to create value for all stakeholders by providing transparent reporting. With good quality disclosure, investors are able to price risk better and seek alignment with long-term focused companies.

2. Strong Board Governance pre-IPO

LGIM believes that having an effective board where directors are responsible for the management of the long term success of the business is critical to strong corporate governance structures. This consists of striking the right balance between having the right competence in the boardroom, a diverse skill set, relevant experience and having a deep knowledge of the company.

Therefore, we would encourage the HKEX to focus on governance preparations pre-IPO (e.g. having good established independent directors on the board before listing). LGIM has experienced too many boards being constructed just before an IPO with directors who do not understand the business. Furthermore, in terms of a newly listed company, we would encourage greater scrutiny on the 'quality' of directors in the boardroom pre and directly post IPO.

3. Delisting process

Whilst focusing on IPOs is important, attention needs to be given to delisting as it plays an essential part in the lifecycle of the market. Market stagnation can occur if delisting processes are not properly set and deployed. Therefore, we would be supportive of a more efficient and transparent delisting regime.

ACTIVITY IN OTHER MARKETS

As highlighted by the HKEX in the New Board Concept Paper[5], LGIM is witnessing a concerning trend in other markets whereby public shareholder rights are being weakened to encourage and enable companies with sub-optimal governance standards to list (for example, in the case of the UK, sovereign controlled companies are being considered). This is deeply concerning because

[4] https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf, Page 13, paragraph 35
[5] https://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf, Page 14, paragraph 43

neglecting the safeguards that protect shareholders will encourage a ‘race to the bottom’ in those markets.

The proposal by the FCA in the UK has already received stark criticism regarding its proposal to create a new ‘premium international segment’ for sovereign controlled companies.

> *"Investors believe a premium listed segment without these investor protections is not a premium segment and will not provide the protections that investors expect"*
> **Chris Cummings, Chief Executive at the UK Investment Association, 13th July, 2017 2017.**

Furthermore, we disagree that not implementing these proposals could pose a threat to the Hong Kong market as an IPO centre. In fact, the Hong Kong market would be praised by international investors for upholding its standards, allowing only good quality companies to enter its market.

Lastly, as one of the largest institutional investors globally with over USD 1 trillion of assets under management globally, LGIM is also a major user of indices. We have noted that FTSE Russell, S&P and MSCI have all recently launched consultations on the issue of unequal/non-voting shares. Our message to the global indices is consistent and aligned with the response given to the HKEX. 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 encouraged global indices to collaborate to ensure they implement consistent rules on issues such as voting thresholds. In addition, where rigorous rules are already in place, these should remain and not be further weakened.

SUMMARY

LGIM believes that this is an opportunity for the HKEX to differentiate itself and become a leading global stock exchange for all market participants. As a regulator, the HKEX can demonstrate its high standards by upholding and valuing shareholder rights.

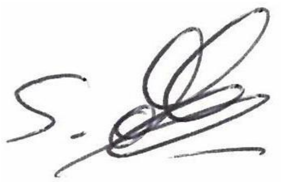
Furthermore, as long term shareholders, we do not see any benefit from the implementation of the New Board. The risk of potentially exposing investors to bad actors and diminishing minority shareholder power by having WVR is greater than the perceived benefit of winning a few high profile listings in the short term. In addition, the substantial damage to the overall market reputation will reduce the integrity of the HKEX as a supervisor of the market.

Therefore, we would encourage the HKEX to reconsider its proposal to create a New Board. As a large and growing investor in Hong Kong, LGIM has a significant vested interest in protecting ensuring market standards are upheld.

Please also note that LGIM is a member of the Asian Corporate Governance Association (ACGA) and stand aligned with their response. We have attached their submission for your reference.

We hope that we have been constructive and remain at your disposal should you wish to discuss any of the points we have raised in further detail.

Yours sincerely



Sacha Sadan
Director of Corporate Governance

David Patt
Senior Analyst, Corporate Governance and Public Policy