

24 March 2023

Hong Kong Exchanges and Clearing Limited

AAMG Response to Consultation Paper on Review of Corporate Governance Code and Related Listing Rules

The below responses to the aforementioned Consultation Paper will be submitted on behalf of the Asset Management Group (“AAMG”) of Asia Securities Industry & Financial Markets Association (“ASIFMA”) to the Hong Kong Exchanges and Clearing Limited (“HKEx”) online system on or before 24 March 2023.

Q1. Do you agree with the proposal to set the limit on general mandate for issuance of new shares at 20% of the total issued shares of a PRC issuer, instead of 20% of each of domestic shares and H shares? Please provide reasons for your views.

NO

We do not agree with the proposal because A and H shares are not fungible and market dynamics in their respective share markets operate differently. The removal of the separate mandate limits at 20% for each of the A shares and H shares may have unintended consequences for H share market price and the interests of existing H shareholders.

Different market dynamics of different types of shares warrants different treatment

A key feature of A shares and H shares is that they are not fungible as stated in the Exchange’s Consultation Paper. The Securities and Futures Commission (“SFC”) in its Practice Note 25 (“PN25”) – *Guidance Note on the application of the Codes on Takeovers and Mergers and Share Buy-backs following the abolition of the Special Regulations and the Mandatory Provisions and other matters relating to offers for A and H shares of a listed issuer*, released on 17 March, also acknowledges this.

The divergence of A and H share prices in the market indicates that their share price is affected by the different dynamics in their respective markets, including different investor base, liquidity, number of A/H shares held by the public, and other local factors, and that A and H shares are different even though they are viewed as the same class of shares following implementation of changes in PRC regulations from 31 March 2023. As discussed in our response to Question 2, non-fungibility of A and H shares warrants their different treatment.

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Unintended consequences from removing the separate mandate limits for domestic and H shares

In general, H shares trade at a discount to A shares so it is more efficient for an issuer to issue A shares (from a cost of equity perspective) rather than H shares. In practice, however, it is not uncommon to observe dual listed companies using general mandate to issue H shares rather than A shares, due to regulatory constraints or other factors in the domestic market.

As stated in paragraph 63 of the Consultation Paper, removal of the separate mandate limits means that a PRC issuer has more flexibility within the overall total issued shares cap to decide how many H shares to issue. The issuer may choose to issue H shares *only*, substantively increasing the number of H shares and diluting the interest and rights of H shareholders. Our members typically see a split of 80:20 between A shares and H shares. If 20% of the total issue shares are issued as H shares in this scenario, the number of H shares post issuance effectively doubles. This could cause severe disruption to the H share price and significantly affect the interest of H shareholders. We have similar concerns for scheme mandates.

Q2. Do you have a concern that given fund raisings through the issuance of A shares may result in an increase in the number of A shares over H shares, the market size and liquidity of the H share market may reduce relative to the A share market? Do you think there should be other provisions to promote the long term development of the H share market, if so please provide reasons for your views and any suggestions.

YES

Our members are concerned that the repeal of separate class meeting requirements in particular would give rise to unequal outcomes for A and H shareholders, resulting in an increase in the number of A shares over H shares. For foreign institutional investors who typically invest in PRC issuers through H shares, the reduction in the existing rights of H shareholders also creates additional hurdles for meeting their stewardship obligations. In the long-term we believe this will lead to a reduction in the size and liquidity of the H share market relative to the A share market.

Although the Exchange is not consulting on the repeal of the separate class meeting requirements, we would like to share our views below on why maintaining the separate class meeting regime is important for protection of minority shareholder rights. We would like to suggest that submitting amendments to issuers' articles of association to a class meeting is needed as a stop gap measure, and maintaining transparency of voting outcomes by share type is also important in promoting the long term development of the H share market.

Repeal of class meeting requirements compromises the current protection available to H shareholders

Decisions around the issuance or repurchase of shares is a key shareholder right, and existing shareholders should have the right to evaluate significant capital decisions and prevent dilution of their ownership without prior consent.

While the current class meeting regime for issuance of new shares and repurchase of existing shares by PRC issuers were introduced initially to offer protection to H shareholders, it has served well as a general protection of the rights of minority shareholders. H shareholders who are typically minority shareholders have been able through class meetings to scrutinise proposals

and if necessary, to veto significant capital decisions around the issuance and repurchase of shares where such decisions may be unfair to a particular class or type of shareholder. To the extent that there may not be many examples of H shareholders exercising this veto right, this may in fact be due to the deterrent effect of the current class meeting regime.

We believe that the (Hong Kong) Exchange's proposed Rule amendments especially in relation to the removal of class meetings would remove this minority shareholder protection currently enjoyed by H shareholders.

Non-fungibility warrants different treatment

The SFC in its PN25 released on 17 March acknowledges that *"the fact that H shares and domestic shares are not directly fungible with each other warrants a different approach when applying certain provisions of the Codes (i.e. Codes on Takeovers and Mergers and Share Buy-backs) to PRC H Share Issuers"*.

Practice Note 25 also states that if an issuer's proposal such as the delisting of H shares *"affects the interests of its holders of H shares to a much larger extent compared to its other shareholders"*, it would justify separate treatment of A and H shares, including maintaining the requirement for separate approval by A shareholders and H shareholders. Apart from delistings, we believe there are other issuer proposals which could potentially affect the interests of A and H shareholders differently, and hence should be voted on and approved by each group of shareholders separately to safeguard their interests.

Rights and bonus share issuances as examples of unequal outcomes

We have previously brought to the attention of the Exchange certain scenarios observed by our members of unequal outcomes for A and H shareholders which can be deemed unfair to H shareholders. For example, a rights issuance on A/H share markets at the same issuance price could result in an issuance price set at a price typically above H share market price, thereby disincentivising H shareholders from participating in the issuance. Meanwhile A shareholders may be able to subscribe for new shares at a discount to the normal A share price. In addition, if the issuance price is at a discount to book value, H shareholders as a group would additionally be forced into dilution of book value per share.

We appreciate that this is an issue with the market price of securities that is already observed under the current regime and given the reduction in the rights of H shareholders expected from the proposed Rule amendments, over time such scenarios could potentially further reduce the market size and liquidity of the H share market relative to the A share market.

Another example of unequal outcomes is the in-principle equal treatment of shareholders from the distribution of either a cash dividend or bonus shares. A decision by a PRC issuer to issue bonus shares in lieu of dividend would result in a poorer outcome for H shareholders where H shares are trading at a discount to A shares.

Whilst we have identified some of the above examples where the interests of A and H shareholders are affected differently, we would suggest that the Exchange consider the impact of the proposed Rule amendment on the H share market both from a Hong Kong market perspective as well as from a foreign investor perspective, especially when it comes to protection of the rights of minority shareholders.

Unintended impact on stewardship efforts

Foreign institutional investors who typically hold the H shares of dual-listed PRC issuers are largely required to uphold higher ESG expectations and standards compared with domestic counterparts in mainland China who hold A shares. This higher obligation is in part due to the laws and regulations of their home countries. The proposed changes reduce the protection of H or minority shareholders creating a hurdle for the stewardship efforts of foreign institutional investors. In addition, and given the potential negative impact on the liquidity of the H share market (from the greater issuance of A shares over H shares), the proposed changes may eventually squeeze out foreign institutional investors altogether.

Requiring issuers to submit amendments to their articles of association to a class meeting as a stop-gap measure to protect H shareholder rights

We expect that PRC issuers should at least be required to submit amendments to its articles of association for the repeal of the class meeting requirements, to separate class meetings of A and H shareholders for approval before such removal takes effect. This provides an avenue for H shareholders to express their position on the repeal of class meeting requirements.

Transparency in voting outcomes as part of provisions to promote the H share market

We would like the Exchange to confirm that it intends to retain separate disclosure of voting outcomes under A, H and total shares. Requiring companies to disclose an analysis of the differences in voting outcomes provides important insights on the key concerns of the different shareholder bases, which is valuable for both shareholders and issuers alike. If an issuer were to proceed with a proposal that previously have been blocked by A or H shareholders, the issuer should have to produce a statement on why it would be in the interests of all shareholders.

Q3. Do you agree with the proposal to set the limit on scheme mandate for share schemes at 10% of the total issued shares of a PRC issuer, instead of 10% of each of domestic shares and H shares? Please provide reasons for your views.

NO

Please refer to our response to Question 1 under Issuance of shares under general mandate.

Q4. Do you agree with the proposal to remove the requirements for directors, officers and supervisors to provide undertakings to the PRC issuers and their shareholders? Please provide reasons for your views.

NO

With the current undertakings, H shareholders may take legal action against directors, officers and supervisors based on the laws and regulations of the most appropriate jurisdiction. Following the adoption of new articles of association by PRC issuers, we are concerned that without a Reciprocal Agreement between Hong Kong and Mainland China in force for matters arising from a PRC issuer's articles of association or PRC Company Law, a H shareholder who obtains a judgement from a Hong Kong court cannot apply directly to a Mainland court for enforcing the Hong Kong judgement. We would recommend such disputes should continue to be settled by arbitration in either Hong Kong or Mainland China at the claimant's election.

Q5. Do you agree with the proposal to move the requirements for compliance advisers set out in Rules 19A.05(2) and 19A.06(3) to Chapter 3A? Please provide reasons for your views.

No comment

Q6. Do you agree with the proposal to remove Rules 19A.05(3), 19A.05(4), 19A.06(1) and 19A.06(4)? Please provide reasons for your views.

No comment

Q7. Do you agree with the proposal to remove the requirements relating to online display and physical inspection of documents under Rules 19A.50 and 19A.50A? Please provide reasons for your views.

NO

There is already material information asymmetry due to disclosures only in Chinese on Shenzhen / Shanghai stock exchanges, and for dual listed companies, just brief notice in English on the (Hong Kong) Exchange. The proposed removal, especially in relation to online display, will further hinder foreign institutional investors' accessibility to information, which can be attributed to a lack of knowledge of alternative information sources and difficulties to access certain Chinese government agencies' portals from overseas. The proposed removal of the physical inspection of documents requirements is not considered an issue if online display is available.

Q8. Do you agree with the proposal to remove the requirements relating to disclosure of material differences between the laws and regulations in the PRC and Hong Kong in listing documents of new applicants that are PRC issuers? Please provide reasons for your views.

NO

Differences between the laws and regulations in the PRC and Hong Kong are an important risk factor that investors need to be aware of. We would prefer for this requirement to remain or at least be provided as an FAQ or guidance for H share issuers to ensure they include in their disclosures. It should also be highlighted in the listing documents that H shareholders will no longer have a veto right over specific types of proposals through the right to separate class meetings. In the case of A and H dual listed issuers, there should also be disclosure of relevant risks associated with potential unequal outcomes for A and H shareholders as discussed in our responses to prior questions.