Hong Kong

Summary of Current Shareowner Rights

Percentages cited reflect information gathered by GMI Ratings about 76 companies in Hong Kong as of 31 August 2012.

Shareowners in the Hong Kong market generally have strong rights that encourage engagement and activism. In reality, however, such engagement is limited and unusual because the market is relatively passive; institutional investors do not generally vote their shares. Shareowner rights are also somewhat weakened by the fact that boards often have a majority of non-independent board members and many companies are controlled by founding families. Although shareowner proposals are allowed at annual general meetings (AGMs), they are rare.

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
What is the average percentage of independent board members on public company boards (% independent board members)?	38%	
What percentage of companies have fully independent audit committees?	52.6%	
What percentage of publicly traded companies have a controlling shareowner (e.g., family, government, majority block holder)?	53.9%	
Is voting by proxy permitted?	Yes	
Must shares be deposited or blocked from trading in order to vote?	No	
Are there share ownership limitations in this market?	No, mostly	Share ownership limitations are not common but may apply to a specific company, such as Hong Kong Exchanges and Clearing Limited, the operator of the Hong Kong Stock Exchange, which has a 5% ownership restriction unless a higher percentage of ownership is approved by the Securities and Futures Commission.

(continued)

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
Are there (other) common restrictions on the rights of shareowners to vote in person or by proxy?	No, mostly	Resolutions are often declared by meeting chairs by a show of hands (i.e., one vote per person), which tends to negate the value of proxies unless a poll (one vote per share) is called. This approach by meeting chairs is common. The law requires certain votes to be held by poll, including votes on related-party transactions, transactions that are subject to independent shareowners' approval, and transactions in which an interested shareowner is required to abstain from voting.
Do companies adhere to a majority voting standard in the election of board members?	Yes	
Do companies allow for cumulative voting in the election of board members?	No	
Are shareowners able to affect a company's remuneration policy through shareowner approval (binding or non-binding) of the remuneration committee report, the proxy's Compensation Discussion and Analysis section, or something comparable?	No	At each annual general meeting, shareowners vote on a proposal to authorize the board of directors to fix the board members' remuneration (but not the remuneration of executives).
Are shareowners able to affect remuneration policy through binding shareowner approval of specific equity-based incentive plans or something comparable?	Yes	Equity-based incentive plans require shareowner approval.
Are shareowners permitted to introduce dissident resolutions (binding or nonbinding) at an annual meeting?	Yes	
Do shareowners have a right to convene a general meeting of shareowners outside the annual meeting process (e.g., an extraordinary general meeting or special meeting) if only 10% or less of the shares are represented in the group requesting the meeting?	Yes	In general, a company must convene an annual shareholders' meeting once every calendar year and not more than 15 months from the date of the last annual shareholders' meeting. Subject to the company's articles of association, two or more members holding no less than 10% of the issued share capital—or if the company does not have share capital, no less than 5% of the company members—can call a shareholders' meeting.

Issue	Current Standard or Usual Practice	Level of Practice Adoption, Exceptions to Usual Practice, and Trends (if any)
What percentage of companies include golden shares in their capital structure?	0%	Golden shares do not exist in Hong Kong.
Are shareholder rights plans (poison pills) allowed in this market?	No	
If shareholder rights plans are in use, do they have to be approved by shareowners?	na	
Do all shareowners have the right to approve significant company transactions, such as mergers and acquisitions?	Yes	
Do companies require a supermajority vote to approve a merger?	No	A majority vote is required.
Are companies subject to a fair price provision, either under applicable law or as stated in company documents (such as the charter or bylaws)?	Yes	
Are class action suits commonly used in this market?	No	Hong Kong's Law Reform Commission recently recommended legislation that would allow a group with a common complaint to sue through a representative. Under the new rule, the ability for class action would be introduced incrementally. The new rule would not apply to equity security shares at first but instead would focus on product liability and consumer fraud cases.
Are derivative suits commonly used in this market?	Yes	

na = not applicable.

Current Engagement Practices and Shareowner Rights Developments

In Hong Kong, shareowner engagement and activism are limited. The most prominent body in corporate engagement is the Asian Corporate Governance Association (ACGA), which collaborates with leading pension and investment funds, financial institutions, listed companies, multinational corporations, and educational institutions seeking implementation of effective corporate governance practices throughout Asia. The ACGA has identified a number of concerns with Hong Kong listed companies, particularly the following: Companies are not required to report annual results within two months of fiscal year-end, quarterly reporting is not mandatory, there is no independent audit regulator, a failed IPO process encourages "overseas listings," there is inadequate disclosure on private placements, and class action suits are not permitted (although this may be slowly changing). The ACGA has also raised concerns about institutional shareowners, who do not typically attend shareowner meetings, often do not exercise their votes, and rarely nominate independent members to boards.

Even though shareowner activism is limited in Hong Kong, David Webb, a former independent non-executive board member at Hong Kong Exchanges and Clearing, has emerged as a prominent proactive investor who engages in activist campaigns with his own funds.

Some practices simply impede engagement in the Hong Kong market. For example, Hong Kong companies have a single-tier board structure with no size limit and an average level of board independence of 38%, which is low compared with other developed markets. This percentage indicates that companies tend to comply with the one-third board independence requirement but generally choose not to meet the higher standards of international best practice. The family-controlled capital structure still common in Hong Kong also raises conflict-of-interest concerns. Indeed, the large number of controlling shareowners in Hong Kong generally weakens minority shareowners' capacity to exercise their rights. Most votes at Hong Kong general meetings are conducted by a show of hands, which means that a vote can be largely determined by how many people are in the room at the time rather than how many votes are cast. Observers of corporate governance in Hong Kong have long criticized this practice.

Hostile takeovers are rare in Hong Kong, mainly because most public companies are closely controlled, either by the founding families or by parent companies, but also because shareowners traditionally either support the local managers or remain passive. Poison pills are not permitted in Hong Kong, and although fair price provisions support general fairness in takeovers, in many companies, a controlling shareowner can weaken the role of minority shareowners.

However, a significant right Hong Kong shareowners possess, which is aligned with international best practice, is the ability to approve or disapprove substantial related-party transactions by vote. Related-party transactions are common in Hong Kong, particularly in controlled companies, so the right to approve them is important. Detailed information on both the nature of such transactions and the method of determining the "arm's length" price has varied, however, and is the subject of considerable criticism.

The Hong Kong Stock Exchange (HKEx) published a new Corporate Governance Code at the beginning of 2012, following the publication of its consultation conclusions in October 2011. The exchange ultimately dropped a proposal to cap the number of independent non-executive director (INED) positions that an individual could hold, as well as a proposal requiring a minimum amount of training (eight hours) per year. The exchange also decided not to pursue a new proposal recommending that issuers be required to set up corporate governance committees on the board. A new rule requiring that INEDs represent at least one-third of the board went into effect at the end of 2012.

The listing rules at HKEx contain a Code on Corporate Governance Practices, including provisions that emphasize the necessity of sound communication with shareholders. It stipulates, for example, that the board should endeavor to maintain an ongoing dialogue with shareholders and, in particular, use AGMs or other general meetings to communicate with shareholders and encourage their participation. The chairman of the board should attend the AGMs and arrange for the chairmen of the audit, remuneration, and nomination committees (as appropriate) to be available to answer questions at the meetings.

In line with the joint response by the Hong Kong Society of Financial Analysts (HKSFA) and CFA Institute to a consultation paper issued by HKEx, this code was recently revised, resulting in a number of improvements. Starting 1 April 2012, the code specifies, for example, that corporate issuers should establish a shareholder communication policy.

Legal and Regulatory Framework

Many key shareowner rights are delineated in the corporate governance standards in the listing rules for companies on the main board of the HKEx or the Growth Enterprise Market.[1] These rules include regulations for the supervision of board members, the operation of boards, the composition of committees, and shareowner rights. Companies must state in their semiannual and annual reports whether they have complied with the rules. These rules are administered by HKEx.

The Hong Kong Securities and Futures Commission (SFC), an independent statutory body, is the main authority for and supervisor of the security market in Hong Kong. To increase public confidence in the market, investor awareness, and investor protection, the commission regulates investment products offered to the public, listed companies, HKEx, share

[1] The Growth Enterprise Market is a stock market set up by the Hong Kong Stock Exchange specifically for growth companies that do not yet meet the requirements of profitability or track record that would allow them to be listed on the main board of the HKEx.

registration approval, and those entities that participate in trading activities. The Takeovers and Mergers Panel (charged with administering the Takeovers Code) and the Takeovers Appeal Committee (responsible for reviewing disciplinary rulings of the Takeovers and Mergers Panel at the request of an aggrieved party to determine whether sanctions are unfair or excessive) are overseen by the Securities and Futures Commission.

In May 2012, the SFC published a consultation paper on regulating IPO sponsors. The paper states that "standards of sponsor work have fallen short of reasonable expectations,"[2] and the regulator clarified that sponsors had civil and criminal liability under the Companies Ordinance.

The basis of shareowner-related law in Hong Kong is the Companies Ordinance. Some of the provisions are equally applicable to companies incorporated outside Hong Kong that establish a place of business in Hong Kong. The ordinance, including subsidiary legislation, is administered and enforced by the Companies Registry.

The Hong Kong Companies Ordinance mandates the practice of "one share, one vote" for listed companies. It also states that shareowners are allowed to bring lawsuits against board members and major shareowners on behalf of the company but that shareowners must acquire judicial approval before launching any derivative actions. An extraordinary general meeting of shareowners may be called, however, by shareowners representing 5% of the issued share capital. Additionally, board members can be removed without cause by a simple majority vote at a shareowners' meeting. Board members are subject to election on a periodic basis by a majority vote. A supermajority vote of shareowners is required to amend a company's articles of association.

Voting in general meetings in Hong Kong is carried out by a show of hands, or one vote per person attending the meeting, regardless of the number of shares the shareowner may hold or present, unless a poll is demanded. Thus, many votes have been approved only by a show of hands, which may not reflect the balance of proxies. Since 31 March 2004, voting by poll (one vote per share) has been required for related-party transactions, transactions that are subject to independent shareowners' approval, and transactions in which an interested shareowner will be required to abstain from voting.

Hong Kong's Law Reform Commission recently recommended legislation that would allow a group with a common complaint to sue through a representative. The plan for the new rule is to introduce the ability for class action incrementally. The new rule will not apply to equity security shares at first but instead will focus on product liability and consumer fraud

[2]www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=12CP1 (p. 2).

cases. The lack of class action rights in Hong Kong became an issue in 2009, following large losses by retail investors on bonds guaranteed by Lehman Brothers Holdings Inc., which had gone bankrupt in 2008.

A report containing the reform proposals was published on 28 May 2012. The mechanics of such class action will not be based on the Western model many are used to. Instead, investors who have purchased securities through banks or brokerages will have to ask permission to sue as a class under the proposed new rule. Such lawsuits would have to be allowed by the government and, if approved, could be financed by the city's Consumer Legal Action Fund. These changes may not provide the class action status some investors want, but they are an improvement over the current practice.

Certain specific voting majorities are required by the Companies Ordinance to authorize certain corporate actions, including the following:

- Amending the articles of association (75% majority) (Section 13, Companies Ordinance)
- Applying to the court for the company to be voluntarily wound up (75% majority) (Section 228[1], Companies Ordinance)
- Redemption or purchase of the company's shares (75% majority) (Section 49BA, Companies Ordinance)
- Varying or modifying class rights (75% majority of shareholders of that class) (Section 63A, Companies Ordinance)
- Reduction of share capital (75% majority) (Section 58, Companies Ordinance)
- Changing the company name (75% majority) (Section 22, Companies Ordinance)

Key organizations with information relevant to shareowner rights in Hong Kong include the following:

Hong Kong Exchanges and Clearing Ltd. (www.hkex.com.hk)

Hong Kong Securities and Futures Commission (www.sfc.hk)

Companies Registry—Hong Kong Companies Ordinance (www.cr.gov.hk)

Hong Kong Institute of Chartered Secretaries (www.hkics.org.hk)

Hong Kong Monetary Authority (www.gov.hk)

Hong Kong Retirement Schemes Association (www.hkrsa.org.hk)

Hong Kong Securities Institute (www.hksi.org)

Hong Kong Investment Funds Association (www.hkifa.org.hk)

Hong Kong Institute of Directors (www.hkiod.com)

Hong Kong Institute of Certified Public Accountants (www.hkicpa.org.hk)

Asian Corporate Governance Association (www.acga-asia.org)

Webb-site (www.webb-site.com)