



CONSULTATION PAPER ON THE PRINCIPLES OF RESPONSIBLE OWNERSHIP

Submissions of the Law Society of Hong Kong

The Law Society provides the following response to a Consultation Paper on the Principles of Responsible Ownership released by the Securities and Futures Commission (“SFC”) on 2 March 2015.

- 1 **Do you agree with the approach (paragraphs 49 to 50) to aim the Principles of Responsible Ownership set out in Appendix A (“Principles”) at all investors and not just institutional investors? If the scope of the Principles is too broad which investors should be excluded or, alternatively, which investors should be included?**

Law Society’s response:

Ultimate investors or beneficial shareholders in the business of a company, that is, the people who actually fund an investment in that company, are not, so long as their investment behaviour is not illegal, responsible to any other person in their investment activities. We respectfully submit that any principles of responsible ownership should only be addressed to regulated professional investors (that is, those who invest and manage funds on behalf of the ultimate investors and only those which are regulated in Hong Kong by a competent authority such as the SFC, “**Regulated Investors**”). We also consider that extension of the Principles beyond Regulated Investors is unlikely to influence current behaviour and is impractical and may even have the unintended and undesirable effect of lending a cloak of legitimacy to certain investors to engage management and directors with spurious questions or claims under the disguise of responsible ownership.

We note the term “stakeholder” is used in the consultation paper numerous times. We suggest the SFC should make it clear what the term “stakeholder” is supposed to mean in this particular context. For example, if the

shareholder is a fund authorised by a Hong Kong or overseas regulator, would that regulator be considered a stakeholder? Where the shareholder is a sovereign fund, is the sovereign government a stakeholder?

- 2 **Given that the Principles will not achieve their objectives unless listed companies welcome both the Principles and the greater engagement from shareholders that will follow, do listed companies and their representatives have any suggestions for the Principles that are likely to encourage the appropriate level of shareholder engagement?**

Law Society's response:

N/A

- 3 **What do institutional shareholders active in investing in Hong Kong companies expect will be the likely costs and benefits arising from their compliance with the proposed Principles?**

Law Society's response:

N/A

- 4 **Whilst SFC does not wish to encourage a close-ended list of the type of institutions which will qualify as "institutional investors" and their agents, SFC would encourage views from the market as to their understanding of the types of institutions which may well fall within or outside of such a broad characterisation.**

Law Society's response:

See our response to Question 1.

- 5 **Should institutional investors be encouraged or obliged to apply the Principles on a "comply-or-explain" basis and, if so, which institutional investors and what should they be asked to disclose and to whom?**

Law Society's response:

The imposition of a mandatory compliance requirement in respect of responsible ownership principles is unnecessary because that would likely lead to a box ticking mentality amongst some Regulated Investors and may

result in requiring the hiring of additional resources and/or seek professional advice to ensure that they comply with the requirements.

Some members consider the adoption of the Principles should be a matter of choice for Regulated Investors such as fund managers, as they may owe fiduciary duties to act in the best interests of the funds they manage and the Principles may conflict with such duties. Such members note that shareholder activism is in fact a strategy adopted by some fund managers and these funds attract certain investors interested in this specialist area. Please also refer to our response to Question 9.

- 6 Will individual or retail investors find the Principles useful? SFC welcome views on whether there are any particular aspects of the Principles that individual or retail investors would like further guidance on.**

Law Society's response:

We respectfully submit that the Principles should not apply to individual or retail investors.

- 7 Should certain types of organisations be required to disclose whether or not they comply with the Principles and, if not, why they do not do so (i.e., on a "comply-or-explain" basis)? For example, should the following be required to comply with the Principles on a "comply-or-explain" basis: (i) institutions authorized and regulated by the Hong Kong Monetary Authority, (ii) approved trustees of Mandatory Provident Fund ("MPF") schemes, trustees of Occupational Retirement Schemes Ordinance schemes and trustees of pooled investment schemes approved for MPF purposes, (iii) insurers, insurance intermediaries and MPF intermediaries authorized and/or regulated by the Office of the Commissioner of Insurance and (iv) entities licensed and regulated by the SFC?**

Law Society's response:

Please see our response to Questions 1 and 5.

- 8 Should entities such as voting services agencies and investment consultants be encouraged to commit to the spirit of the Principles, and if so how this should be facilitated?**

Law Society's response:

Voting services agencies and investment consultants are not shareholders or investors and the Principles are irrelevant to them.

- 9 **As all Hong Kong institutional investors will be encouraged to apply the Principles, are there any hurdles or other reasons that would prevent or discourage them from doing so?**

Law Society's response:

We foresee that a major hurdle would be the cost of compliance. For Regulated Investors which hold interests in a large portfolio of companies in different industries, another major hurdle would be the practicality of compliance with the requirement to engage with the portfolio companies: engaging with each company or most companies in its portfolio could be a mammoth task and, in some cases, meaningless.

Some members are of the view that, whether the resources of complying with the Principles are allocated internally or by engaging external advisors, the negative impact of the associated cost on a Regulated Investor's return is not likely to be welcome and therefore are in favour of a regime that allows Regulated Investors to choose to adopt the Principles on a voluntary basis, after taking into account the impact on the return to ultimate investors. The cost of compliance may ultimately impact the attractiveness of the Hong Kong market for Regulated Investors.

We note Principle 3 suggests investors should escalate engagement with a company when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks. We also note Principle 5 recommends investors to collaborate with each other at times of significant corporate or wider economic stress. These principles must be adhered to within the remits of legislation and SFC's rules. For example, collaboration among investors must not trigger a presumption of the investors as "acting in concert" under the Takeovers Code or response from companies during or following an investor's engagement must not lead to the companies (or at least those which treat these engagements seriously) disclosing inside information in breach of the Securities and Future Ordinance's information disclosure regulations. Further guidelines from relevant regulators would be necessary.

- 10 **The Principles are aimed at investors of Hong Kong listed companies and are not intended to apply extraterritorially. Should investors based**

in Hong Kong be encouraged to abide by the codes or principles of other jurisdictions relating to their foreign investment?

Law Society's response:

We submit in our response to Question 1 that the Principles should only be addressed to Regulated Investors regulated by competent authorities in Hong Kong. If the Hong Kong regulators consider any provision in any code or set of principles adopted by overseas authorities is appropriate, they may consider amending or supplementing the existing Principles. On the other hand, we respectfully submit that the Principles should be addressed to Hong Kong Regulated Investors irrespective of the geographical spread of the underlying investments. In other words we submit that the Principles should not distinguish between those Regulated Investors which invest in Hong Kong listed securities and those which invest elsewhere. We envisage that there will be areas of difficulties of compliance where the laws or regulations of the foreign (including, in this context, the PRC) (or, indeed, Hong Kong) jurisdiction or regulatory bodies present obstacles.

- 11 How can foreign investors in Hong Kong listed companies be encouraged to commit to the spirit of the Principles in respect of their holdings in Hong Kong companies? Do foreign investors foresee any barriers or difficulties in doing so?**

Law Society's response:

We submit in our response to Question 1 that the Principles should be addressed to Regulated Investors regulated by competent authorities in Hong Kong. Foreign professional investors who are not required to be regulated in Hong Kong may well have similar overseas requirements to comply with or to consider.

- 12 Do investors who operate on a cross-border basis envisage any potential conflicts which might arise between requirements or codes in place in other countries and the proposed Principles?**

Law Society's response:

N/A

- 13 What are institutional investors' current practices on disclosing information on their engagement policy, including any national or international standards they follow?

Law Society's response:

N/A

- 14 SFC would also welcome views on the policy objectives against which the SFC should judge its approach to the Principles. The proposed objectives are to:

- promote a sense of ownership amongst institutional investors in order to encourage Hong Kong and foreign shareholders to voluntarily apply and report against the Principles;
- ensure that engagement is closely linked to the investment process;
- contribute towards improved communication between shareholders and the boards of the companies in which they invest;
- secure sufficient disclosure to enable institutional shareholders' prospective clients to assess how those managers are acting in relation to the Principles so that this can be taken into account when awarding and monitoring management mandates.

Law Society's response:

We agree generally with these objectives.

- 15 Should compliance with the Principles be monitored? If so, which regulator should be responsible for doing so? For example, should it be the SFC or should it be the primary regulator in each respective industry?

Law Society's response:

Being the engineer of the policy objectives and the body which will ultimately implement the proposal, should it be considered beneficial, the SFC is the appropriate regulator to monitor as to compliance with the Principles amongst the Regulated Investors community (or, if a voluntary regime is adopted, the extent to which the Principles are adopted by Regulated Advisers).

The Law Society of Hong Kong

9 June 2015