



香港財經分析師學會

THE HONG KONG SOCIETY OF FINANCIAL ANALYSTS

2nd June 2015

Sent by Email and by Post

Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs / Madams,

Re: Consultation Paper on the Principles of Responsible Ownership

The Hong Kong Society of Financial Analysts (HK SFA) welcomes this Hong Kong Securities and Futures Commission (SFC) initiative. To maintain Hong Kong's competitive position (align it with that of the other developed financial markets), developing a better corporate governance eco-system is a given. Added, this initiative mirrors the first line of the HK SFA's mission statement: "...to raise the standard of practice in the financial industry...". We encourage our members (some of them are asset owners and asset managers) to put clients' interest first and diligently execute their fiduciary duties. Corporate governance, for sure, is one of the factors that active fund managers would consider in their investment process. Logically, appropriate actions would be taken to safeguard shareholder's interest on the issues that require shareholder's approval.

It is not obvious that the stewardship responsibility should lie with shareholders. For instance, shoppers who buy counterfeit or defective goods should not be responsible bringing the offending shop-owner to justice. Normally, the shopper would make complaints with the Consumer Council, which in turn will take action against the shop-owner. Similarly it is perhaps more effective to improve corporate governance through the strengthening of board stewardship (particularly the role played by the Independent Non-executive directors) than shareholder responsibility.

While we support the notion of responsible ownership, it should be on a voluntary basis, given the resources consideration. Before the implementation of the "comply or explain" requirement for licensed asset managers in Hong Kong, we encourage the regulatory bodies to take a study on the effectiveness of this requirement on improving corporate governance in the countries which have adopted this policy such as the UK, Japan and Australia. In addition, the study should consider stock market diversity (particularly that long-term investors are not the only players), shareholder composition of Hong Kong's listed companies and the rising importance of low-fee passive investment. Furthermore, consideration should also be given whether the new requirement will disadvantage smaller asset managers given its fixed cost burden.

Some of our members doubt the effectiveness of the implementation of the "Principles" by asset owners and asset managers. Their concern is that this is just a first step towards additional regulation and more "forced" fiduciary duties. It is advisable that the regulatory body should clarify that with the disclosure of additional details. Even though the implementation of the Principles is not required by law, there could be implied legal liabilities for fund managers.

We hope our response to the consultation paper can help improve Hong Kong's competitiveness as an international finance centre while not burdening the industry and shareholders.

Yours sincerely,
For and on behalf of
The Hong Kong Society of Financial Analysts

Frederick Tsang, CFA
President and Chair, Advocacy Committee

Jimmy Jim, CFA
Chair, Advocacy Committee



Appendix: HKSFA's Reply to the Specific Questions.

- Do you agree with the approach (paragraphs 49 to 50) to aim the 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?
- The HKSFA does not agree with including all investors to be in compliance with the Principles. We believe that cost considerations and their small positions in listed companies justify exemptions for smaller institutional investors and asset managers.
- We propose classifying investors into different categories, such as: active long-term investors, passive index benchmarking investors, long-short hedge funds and quantitative fund managers and require for different levels of reporting for each.
- There should also be distinction between asset owners and institutional asset managers who only act as agents for their clients.

- 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?
- N.A.

- 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?
- Costs will be significant for small fund management set-ups with an investment strategy of holding a highly diversified portfolio. We believe the new requirement will encourage smaller institutional asset manager to relocate to other regional financial centres, with Singapore being the obvious beneficiary.
- We believe that compliance will benefit major long-term institutional investors holding significant stakes in listed companies as it will attract additional AUM from asset owners to their platforms.
- Compliance could also improve Hong Kong's standing as a reputable financial centre due to the improved corporate governance it demands.

- Whilst we do not wish to encourage a close-ended list of the type of institutions which will qualify as "institutional investors" and their agents, we 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.
- Licensed institutional investors in Hong Kong should fall within the category, while unlicensed institutional owners in Hong Kong fall outside the category.
- Smaller asset managers and asset owners with AUM size under a threshold should be excluded.



- Passive managers should also be exempted.
- 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?
- All institutional investors should be encouraged to apply the Principles. Significant long-term active institutional investors should observe with the “comply or explain” of the Principles.
- They should disclose their general policies to their investors on proxy voting, keep record of proxies voting and explain how to handle conflicts of interests if such arises. Such records can be made public in the websites of the SFC or their respective trade and professional associations.
- Will individual or retail investors find the Principles useful? We welcome views on whether there are any particular aspects of the Principles that individual or retail investors would like further guidance on.
- They should generally not find the Principles useful except for using them to pick an asset manager. Specific guidelines on how they should cast their votes under real-life circumstances would be helpful.
- Due to the fragmented nature of the retail investor base, the SFC may consider setting up a retail investor coalition body to channel their concerns into a constructive and meaningful influence on the investee companies.
- 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 (ie, 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 HKMA, (ii) approved trustees of MPF schemes, trustees of ORSO20 schemes and trustees of pooled investment schemes approved for MPF purposes, (iii) insurers, insurance intermediaries and MPF intermediaries authorized and/or regulated by the OCI and (iv) entities licensed and regulated by the SFC?
- No mandatory compliance should be established at this stage. Regulated bodies listed above are encouraged to join forces with a uniform requirement.
- Long-term investors should be encouraged to comply with the Principles. The cost of short-term investors applying the principles likely to outweigh the benefit.
- We should rely on market forces to decide whether or not beneficiary owners are satisfied with their asset managers’ existing policies on responsible ownership.
- 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?
- They should be encouraged to provide analytical services and evaluating options for the ultimate shareholders, particularly with regards to controversial issues.



- 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?
 - Administrative costs, impracticalities and conflicts of interest are the major issues.
 - Large institutional investors may already have sufficient channel to influence their investee companies.

- 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?
 - Investors should be encouraged to abide by the codes or principles as much as they could, while overseas investors should observe their local codes or regulations.

- 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?
 - The regulatory bodies should host education and outreach sessions.
 - Foreign investors generally prefer passive investment products to active products and therefore may not be interested in taking part in the stewardship of individual listed companies.

- 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?
 - We do not anticipate significant conflicts. The code of conduct should generally be in line with the global principles of corporate governance.

- What are institutional investors' current practices on disclosing information on their engagement policy, including any national or international standards they follow?
 - Current practices are to minimize future liabilities as much as possible. There are no over-promises on things that they may or may not deliver.

- We 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.
- 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?
- The SFC should not put undue burden of preventing unsatisfactory corporate behavior on institutional owners of the listed companies. However, through education and outreaching activities, the regulatory bodies can encourage the industry and all shareholders to exercise their ownership rights in protecting of their interests.
- Regulators should play a greater role in preventing and disciplining bad corporate behaviors such as allowing corporations to issue 20% of its capital at a big discounted price without seeking shareholders' approval once a general mandate was obtained during the AGM.
- That said, voluntary annual disclosure by designated asset managers about their guidelines and proxies voting record in the SFC website should be encouraged. Professional industry associations and respective regulatory bodies (e.g. insurance, HKMA) should assist the efforts.