26 November 2019

Shri Amarjeet Singh
Executive Director
Securities and Exchange Board of India
SEBI Bhavan Plot No. C4-A
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India

Dear Amarjeet,

Re: SEBI Differential Voting Rights Shares Framework

We write further to our letter of 7 May 2019 and to the subsequent approval by the Securities and Exchange Board of India (SEBI) of its framework for issuance of differential voting rights (DVR) shares in June. For SEBI's future reference, we set out in this letter some information about the use of similar arrangements elsewhere in the Asia-Pacific region and in the US, together with some observations about current investor attitudes to companies which have adopted dual-class share structures.

The Asian Corporate Governance Association (ACGA) is an independent, not-for-profit association chartered under the laws of Hong Kong. The Association is dedicated to assisting companies and markets across Asia in their efforts to improve corporate governance practices. In our educational outreach, we are guided by a practical, long-term approach. ACGA's operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as listed Asian companies, international accounting firms, business associations and universities. ACGA now has more than 110 organisations as members, two-thirds of which are institutional investors with more than US$32 trillion in assets under management globally. They are also significant investors in the Indian market.

Ongoing concerns

Compared to the consultation proposals published in March 2019, the final version of the DVR shares framework incorporates some additional legal provisions aimed at mitigating governance risk, and, naturally, we welcome those. We also welcome the decision to exclude from the framework, for the time being, the issuance of fractional rights shares by listed companies. We would hope that any future proposal to extend the framework to such shares would be subject to a fresh public consultation in order that market participants might have the opportunity to make updated representations to SEBI in light of their experience with the superior voting rights framework.

We note that SEBI has limited the availability of a Main Board listing to companies with superior voting rights shares to companies that also fall within the definition of a "tech

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company" as described in 4.2.2(i) of the DVR shares framework document. We consider this to be a prudent limitation on the scope of the new regime (although the definition is still relatively broad), and we hope that SEBI will take into account the evolving market experience of dual-class share structures before contemplating any widening of this eligibility condition.

In the consultation, SEBI proposed a sunset clause initially limited to five years, with an option to extend it for another five years upon approval by shareholders. We asserted that an extension defeated the purposes of a sunset clause, but the wording also left open the possibility of a company continuing to ask for five-year extensions indefinitely. We note that while SEBI continues to allow for an extension of the sunset clause, it has closed the loophole and declared it a time-based sunset clause:

"The SR shares shall be converted to Ordinary Shares on the 5th anniversary of listing. However, the validity of SR shares can be extended once by 5 years through a resolution. SR shareholders would not be permitted to vote in such resolutions. SR shareholders can convert their shares to ordinary shares at any time prior to Sun-set."

Notwithstanding the changes and clarifications made to the version of the framework published in March 2019, our view remains that the introduction of the DVR shares framework is a retrograde step in the development of India's capital markets and brings with it significantly heightened risk of investor detriment, especially given the limited range of legal remedies available to minority shareholders.

Dual-class shares in other Asia-Pacific markets

As SEBI noted in its consultation, a number of markets in other countries in the Asia-Pacific region have changed their rules in order to accommodate the offering of shares by issuers that wish to adopt a dual-class share structure. However, the issuer response has been uniformly lukewarm across the region. In our view, this limited degree of interest reflects two issues. First, it appears clear that the vast majority of new issuers see no need to adopt a dual-class share structure in order to continue to deliver shareholder value after listing. Public offers by companies with dual-class structures remain the preserve of a relatively small number of new technology companies. Secondly, there is increased investor awareness of the corporate governance risks inherent in dual-class share structures, in light of well-publicised corporate governance problems at a number of well-known companies. It is our sense that a perception of increased investor caution about dual-class structures may itself lead issuers to stick with the conventional one-share-one-vote structure in the interest of ensuring strong investor interest in the public offer.

The decision by SEBI to launch a framework for DVR shares therefore comes at a time when market participants have become increasingly cognizant of, and resistant to, some of the governance risks that are hardwired into companies which adopt dual-class share structures.

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In 2018, the Stock Exchange of Hong Kong made the case that it had to change the listing rules because there was a pipeline of companies wanting to list in Hong Kong with a dual-class share structure. The rules were subsequently changed, and since April 2018 certain sorts of companies whose business is deemed to be sufficiently "innovative" in character are in principle able to apply to make an initial public offer by way of a Main Board listing, notwithstanding that the company in question has a dual- or multi-class share structure.

However, the response from prospective issuers has been muted. To date, only three issuers with weighted voting rights structures have listed. Xiaomi Corporation and Meituan Dianping listed ordinary shares in, respectively, July and September 2018, and Alibaba Group Holding Limited in November 2019.

In the first half of 2019, the Hong Kong IPO market has been relatively strong, with 84 listings and almost HK$70 billion (US$8.94 billion) raised. As such, at the mid-point of 2019, it ranked number one in the Asia-Pacific region for IPOs, and number three globally. None of the new issuers in the first half of 2019 adopted a dual- or multi-class share structure.

In the course of November 2019, Alibaba Group Holding Limited obtained approval for a secondary listing in Hong Kong. The Alibaba Partnership's director nomination rights are categorised as a weighted voting rights structure under the Hong Kong listing rules and as a result Alibaba Group Holding Limited is deemed to be a company with a weighted voting rights structure. Its IPO took place on 26 November 2019. In addition, Megvii Technology, which will have a weighted voting rights structure, has applied for a Main Board listing.

In Singapore, with effect from June 2018, it has been possible for an issuer to be listed on the Mainboard of the Singapore Exchange by way of primary listing with a dual-class structure if it can establish that it is suitable for listing with such a structure. To date, no issuer has availed itself of the Singapore Exchange's rule change. Since the introduction of the rule change there have been two Mainboard IPOs, each of which has come to the market with a one-share-one-vote structure.

In mainland China the SSE STAR Market was launched in June 2019, which aims to support high-tech industries and strategic emerging industries. The SSE STAR Market permits companies with dual-class share structures to list on it for the purpose of public offering. To date, one company, UCloud Technology Co, with a dual-class share structure has been approved by the SSE for a listing (although it has not yet listed, pending further approval from the CSRC). We are not aware of any other dual-class share structure prospective applicants. It is still too early to draw firm conclusions on the future of dual-class shares in these markets but what is clear so far is that the vast majority of listing applicants have not seen any reason to abandon the one-share-one-vote structure. The dearth of listing applicants with a dual- or multi-class share structure in Hong Kong, in what is a large, liquid and sophisticated IPO market, is particularly striking.

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Current investor attitudes
Recent market experience continues to demonstrate increased investor disquiet about the governance risks associated with dual-class share structures, and specific, high-profile instances of governance problems have served to sensitise the broader market to the risks.

As SEBI will be aware, investor concerns about the then voting power of one of the co-founders of Uber Technologies prompted that company to abandon its dual-class structure at pre-IPO stage in order to secure pre-IPO funding in 2017. It is striking that by the time of its IPO in May 2019 Uber had come full-circle and made a commitment to governance by one-share-one-vote a central part of its offer to investors (and included it as such in its prospectus).

SEBI will be equally well aware of the decision in September 2019 by We Company to postpone its proposed IPO. In addition to investor concerns about the valuation of the company, there was strong investor opposition to a number of the company's corporate governance practices, largely flowing from the disproportionate voting power of the company's co-founder and then CEO. As a condition of supplying additional funding to We Company, investors insisted on corporate governance reform, including a significant reduction in the voting power of the co-founder, and by then former CEO.

However, investor concerns about dual-class share structures are by no means confined to a company's pre-IPO life. It is often said by advocates of listing for dual-class issuers that investors in such shares are contented buyers who have invested knowing the risks and have priced the ordinary shares accordingly. The reality is that many investors, both active and passive in nature, often find themselves commercially obliged to buy such shares, notwithstanding concerns about governance risk. The consequence is that many companies with a dual-class share structure begin the post-IPO stage of their development with an often substantial block of shareholders unhappy with the company's corporate governance. A review of recent votes at annual shareholder meetings of some of the largest US technology companies with dual-class share structures reveals extensive and serious concerns on the part of institutional investors about corporate governance practices in those companies. Indeed, institutional shareholders have voted on a number of occasions in favour of resolutions that would require Facebook and Alphabet, to name two, to implement a recapitalisation plan for all issued stock in those companies to have only one-vote per share. The evidence therefore suggests that stock exchanges and regulators that seek to introduce dual-class issuers to their markets may well end up with listed companies which have shareholder disharmony hardwired in from the beginning. In our view that remains an undesirable outcome for all concerned.

We hope that you will take into consideration the experience in Hong Kong, Singapore and the US as part of your review of the operation of the DVR shares framework, once it has been implemented into national law. Investors, both retail and institutional, have become much more demanding of good governance at companies and very much more alert to the risks of investing in companies that fail to treat their shareholders equally.

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We look forward to a continuing dialogue with you.

Yours truly,

Jamie Allen
Secretary General

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