ACGA Council

Founding Chairman:
David Chiang

Chairman Emeritus:
Linda Tsao Yang

Chairman:
Douglas Henck
Chairman & CEO
Aegon Asia

Vice Chairman:
Anthony Muh
Partner & CEO
Capital Management
H.R.L. Morrison & Co

Members:
Janet De Silva
President & CEO
Toronto Region Board of Trade

Steve Fuller
Senior Vice President
The Chubb Corporation

Rob Morrison
Chairman, Kiwibank

Stan Shih
Honorary Chairman
Acer Inc.

Elizabeth Sun
Director of Corp Comms
TSMC

Pote Videt
Managing Director
Lombard Investments

Steven Watson
Partner
Capital World Investors

Peter Yam
Retired President
Greater China, Emerson

Yuelin Yang
Managing Director
Asset Management
IMC Industrial

Secretariat:
Jamie Allen
Secretary General

Michael Cheng
Research Director, China & HK

Vanessa Chan
Office Manager

June 16, 2015

Securities and Futures Commission
Attn. Mr. Charles Grieve
Senior Director, Corporate Finance Division

35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

By email and post

Dear Mr. Grieve,

ACGA's Response to the Consultation Paper on the Principles of Responsible Ownership ("the Consultation")

We welcome the opportunity to respond to the Consultation; and we are grateful for the two-week extension that you have given us, so that we can incorporate the points we covered in the discussions that we had in conference calls with our investor members on June 2-3, 2015 and corporate members on June 11, 2015 on this subject.

The Asian Corporate Governance Association (ACGA) is a not-for-profit association chartered under the laws of Hong Kong. The association is dedicated to assisting companies and markets across Asia in their effort 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 well as listed Asian companies, law and accounting firms, and universities. ACGA now has over 100 corporate members, two thirds of which are institutional investors with around US$19 trillion in assets under management globally. They are also significant investors in the Hong Kong market.

Overall Comments and Recommendations

Before we answer the questions raised in the Consultation in detail, we would like to highlight our most important recommendations in this Consultation response.

For Hong Kong to fulfill its potential as a world-class financial centre, it is crucial in our view that asset owners and asset managers play a more engaged role in the architecture and practices of the market. Without fuller, more active participation in the governance of our market, it will become increasingly difficult to balance the diverse concerns of market participants while placing a necessary priority on the needs of long-term investors who form the bedrock of our market.

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

In our view, asset owners are ultimately responsible for the mandate they give to external asset managers and/or service providers. Subsequently, asset managers are also responsible for the mandate they give to their external asset managers and/or service providers and how they serve their clients' best interests and report to them (the "Investment Chain").

For the proposed Principles of Responsible Ownership (the "Principles") to be effective, it is crucial that the (domestic) institutional investors, both asset owners and asset managers, in the Hong Kong market demonstrate leadership. Hong Kong's statutory asset owners set the tone for domestic investors and their policies are critical to establishing a value chain for asset owners. As a result, we believe that the Principles should at least be mandatory for major statutory local bodies, eg, the Hong Kong Monetary Authority, the Hong Kong Jockey Club and the Hospital Authority, to report on a comply-or-explain basis in order to establish a clear ownership obligation to the asset owners.

In the first stage of implementation, we would advocate that the Principles be voluntary on a comply-or-explain basis for all investors other than the statutory bodies. Rather than encourage tick-the-box compliance, this would create tangible incentives for Hong Kong asset managers to define a high level of performance on forms of responsible ownership appropriate to the Hong Kong market and their individual business models. This competition in tandem with transparency would then support long-term value-added distinctions between asset owners and asset managers rather than encourage a low standard of safe harbour-style compliance.

We believe that the effectiveness of the Principles rests on a broad application to all investors. Initially, we would prioritise all institutional and corporate investors falling under the relevant definitions in the Securities and Futures Ordinance (the "SFO") —with a particular focus on (domestic) Institutional Professional Investors and Corporate Professional Investors. The key to effective implementation, regardless of the initial target groups, will be how asset owners and asset managers are asked to report on how they fulfill their responsibilities, including where applicable how they supervise and manage services provided by their advisors if they have outsourced the relevant activities. We would stress, however, responsibility for responsible ownership cannot be delegated, and asset owners and asset managers should monitor the responsible ownership activities of the providers to ensure the agents meet their own standards.

To ensure that the Principles serve as a true catalyst for long-term value-added responsible ownership, we would stress the importance of engagement with directors of listed companies and similar senior investor representatives. Active and informed participation from both the corporate and investment communities will be crucial to nurturing the governance DNA and practices of the Hong Kong market.

Detailed Responses to Consultation Questions

1) Scope of target group for the Principles

- We support the Securities and Futures Commission's (the "SFC") decision to define the relevant group as "all investors" in light of the significance of individual and corporate investors in the Hong Kong market.

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

- As statutory and/or public bodies managing public funds, the Hong Kong Jockey Club, the Hospital Authority, and the Hong Kong Monetary Authority which oversees the Exchange Fund and other sovereign wealth entities should be required to "comply or explain" regarding the Principles.
- Steps must also be taken to ensure that Mandatory Provident Fund providers are addressed as a high priority component of the target group.
- While the proposed formulation targeting individual and corporate investors appropriately locates the Principles at the highest and most fundamental level, we are concerned that the Hong Kong market currently lacks suitable means for engaging smaller retail investors in the stewardship process envisioned by the Principles. In this regard, it may be appropriate to encourage and/or support the development of retail shareholders' groups to provide greater participation in and awareness of responsible ownership issues. In Asia, examples of such retail shareholders' groups can be found in Malaysia, Singapore and Taiwan.

2) Comments from companies to "encourage the appropriate level of engagement"

- The first critical point to stress is that engagement in Hong Kong must be elevated from a management-mediated process, often led by investor relations (IR) personnel, to a dialogue with and informed by the participation of board directors who hold fiduciary responsibilities.
- It should also be noted that engagement is most effective when the focus is on specific material issues that influence company's strategy and/or performance, rather than generic issues of good corporate governance practice that are already highlighted in Hong Kong's Corporate Governance Code.

3) Cost of compliance with the Principles for institutional investors

- It is important to differentiate between one-off and ongoing costs. Any asset manager operating in other markets (where there is a stewardship code, eg, the United Kingdom (UK) and Japan) will already have the infrastructure in place to comply on a cost-effective basis.
- While there will be costs associated with comprehensive and appropriate adherence to the Principles, these are costs that will also yield reputational benefits to stakeholders of the asset owners and asset managers.
- Costs can be limited if the SFC were to ensure that adequate resources are made available to target investor groups to define the nature of good practice. The SFC may wish to make reference to guidelines published by groups such as the Governance Institute of Australia on "Improving engagement between ASX listed companies and their institutional investors: Principles and Guidelines".
- Compared to other costs of proper asset management, any costs associated with implementation of responsible ownership are relatively minimal and there is a general consensus in major markets that the benefits (see also question 9 below) outweigh these costs.

4) Types of institutions that should fall inside the "institutional investors and their agents" list

- For ease of interpretation and local relevance, we recommend that the definition of institutional investors and their agents reflect existing definitions in the SFO for Professional Investors (see page 2 above).

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

5) Comply or explain obligation and what "institutional investors" should be obliged to disclose and to whom

- We believe that disclosure of policies and outcomes is an essential complement to implementation of the Principles. As a result, we believe that Hong Kong's statutory asset owners should be required to disclose and that all institutional investors should be strongly encouraged to disclose in a comply or explain context (see page 2).
- To ensure that a culture of informative disclosure develops, we would recommend that boilerplate disclosure be discouraged at the outset and that tailored examples of good practice be provided. Just as Hong Kong Exchanges & Clearing (HKEx) has provided web-based resources to stakeholders concerned with environmental, social, and governance disclosure, we believe that the SFC could play a constructive role by establishing web capacity designed to highlight examples of good practice on disclosure as well as examples of disclosure which should be avoided.
- It would be appropriate to encourage web-accessible disclosure at the institution level. Fliers and mailers should be discouraged (or even prohibited) as adequate means of disclosure under the Principles.

6) Making the stewardship process useful to individual and retail investors

- Product-specific disclosure or some form of labeling would be a suitable topic for future consultation once the implementation of the Principles has matured. We believe that there is a case to be made for disclosure or labeling for products and investment programs focused on active equity or corporate debt investment strategies, particularly those that might be subject to concentration risk.
- Again, it may be appropriate to encourage and/or support the development of retail shareholders' groups to provide greater participation in and awareness of responsible ownership issues (see page 3).

7) Who should be <u>required</u> to comply: (i) HKMA authorized and regulated institutions, (ii) approved trustees of MPF or ORSO schemes and MPF approved pooled schemes, (iii) insurers and MPF intermediaries authorized/regulated by OCI, and (iv) entities licensed and regulated by the SFC

- As discussed above, we would urge that implementation of the Principles be made mandatory for all statutory and public bodies (see pages 2 and 3 above), to report on a "comply or explain" basis.

8) Inclusion of voting services and investment consultants: implementation challenges

- In our view, asset owners are ultimately responsible for the mandate they give to external asset managers and/or service providers. Subsequently, asset managers are also responsible for the mandate they give to their external asset managers and/or service providers and how they serve their clients' best interests and report to them (the Investment Chain). Because all investors defined (or in many cases regulated) under the SFO fall under the scope of the Principles and they bear the ultimate responsibility for the use of voting services and investment

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

consultants. we do not see compelling justification for these voting services and investment consultants to be included under the scope of the Principles.

- Both the UK and the Japan stewardship codes have extended their application to proxy advisors, but the responses of proxy advisors have not been considered to be effective. In the UK, according to the UK Financial Reporting Council (FRC), proxy advisors "are accused of taking a 'tick-box' approach to governance, with inadequate consideration of company circumstances and explanations".
- We believe that the UK and Japan experience raise important considerations and would recommend that questions related to the regulation of proxy advisors be a subject of a separate consultation. Inclusion of proxy advisors in Hong Kong's stewardship process would distract from a focus on the true stewards of capital and misplace the ultimate responsibility for performance and transparency.

9) Hurdles that would prevent application of the Principles

- Experience in other markets suggests that there are not major hurdles to implementing stewardship codes similar to the proposed Principles, especially when constructive steps have been taken to educate market practitioners about the long-term benefits of good responsible ownership. Indeed, it would be hard to cite an example of a market where investors and/or practitioners—in the face of increasingly complex markets—are requesting less responsible ownership.
- At a technical level, we believe that it would be prudent to review potential barriers to efficient corporate engagement that may be embedded in the rules related to concert parties and insider trading and/or other potential practical barriers in the Investment Chain, e.g. the use of "street names" that hinders the identification of the ultimate beneficial owner. In particular, we would also encourage the SFC to provide more clarity on the issue of collective engagement between institutional investors, and the implications on "acting in concert" (eg, triggering a requirement to make a general offer) under the Hong Kong Code on Takeovers and Mergers.
- Hurdles, where they do arise, are most likely to relate to how firms chose to manage conflicts of interest and in decisions related to the consistency of application of positions related to engagement. As in question 3, we support the SFC in providing guidelines (referencing overseas precedents eg, Australia).

10) Obligating Hong Kong investors to follow codes or principles of other jurisdictions

- We believe that the statutory and public bodies should be required to cross-reference their adherence to codes such as those in the UK or in Japan.
- Generally, there is considerable similarity amongst the codes in other jurisdictions. We believe that it might be appropriate to permit investors to standardise their reporting (i.e., providing one document for several markets) or to simply refer back to their home country reporting, with a top up on each foreign market.
- There is a global best practices trend on reporting on responsible ownership. Please refer to question 13 for more details. Reports under this trend may provide useful information for Hong Kong concerning the ability of comparable global investors to follow and report on the codes of other markets.

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

11) Encouraging participation by "foreign" investors and barriers to participation

- As noted above, any company offering investment products and services that is regulated in Hong Kong should be encouraged to follow the Principles and/or adherence to this domestic code, develop and implement appropriate policies, and to report on their activities.
- Most "foreign" institutional investors in Hong Kong invest and operate globally. Therefore, many are required to adhere to responsible ownership (stewardship) codes in other major markets and/or are already subject to fiduciary duties (as applicable under their jurisdictions).
- We would not anticipate meaningful barriers inasmuch as it is only natural that the level of resources committed by individual institutions will be consonant with their market commitment, relevant risk exposures, and opportunities. Indeed, this view is reflected in our desire to see incentives created to permit firms to differentiate their approach, thereby offering investors an opportunity to distinguish strong versus weak performers on responsible ownership.

12) Are conflicts with other codes envisioned?

- Although the focus of this consultation is responsible ownership (stewardship), we would note that effective implementation of the Principles will naturally draw investors into a more active and constructive dialogue with listed companies. As a result, it would be appropriate to use this process as a catalyst for review of the Hong Kong Corporate Governance Code. Indeed, as the primary stewards of a company are the directors, there may be merit in reviewing assumptions about the practical responsibilities of boards and directors to engage with investors and to define examples of good practice relevant to the Hong Kong market. In this regard, our responses to questions 3 and 9 raise important related issues for consideration.

13) Institutional investors – common practices for disclosing engagements

Based on our research and views on global best practices on disclosures of activities similar to those envisaged under the Principles (e.g. stewardship or responsible investment) and/or the input from ACGA's Investor Members, we want to highlight the following broadly accepted practices. Some of these practices we see as minimum standards, some practices already applied by some (global) investors may still be somewhat more aspirational at the introduction of these Principles but can be seen as emerging (global) best practices:

- We would like to stress that many (global) institutional investors generally associate the terminology "engagement" as one of a wide array of responsible ownership activities. They define it as the most progressive responsible ownership activity with a clear objective to achieve tangible improvements at the investee company. Other responsible ownership activities generally include fact finding and/or checking, informed voting at annual shareholders meetings (AGM's), (private) constructive dialogues with investee companies and/or advocacy (e.g. responding to consultations like these).
- Not only has the amount of responsible ownership activity disclosed by institutional investors increased in recent years, also the quality thereof.
- Increasingly, institutional investors utilise web-based disclosure of their responsible ownership activities. Apart from communication in their native language, investors following best practice often provide the core information in

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

other international languages, in particular in English. We recommend this to become the common practice.

- We see the disclosure of relevant policies, in particular voting guidelines and/or engagement policies as a minimum standard. The vast majority of our Investor Members disclose their global policies. It is notable that some also disclose regional and/or country specific policies and which stewardship code(s) their offices are following in different regions.
- The level of disclosure, whether confidential or public, varies throughout the Investment Chain, but we see increasingly that asset managers and/or service providers report on their responsible ownership activities and provide their clients, and ultimately the asset owners, with the appropriate information to allow them to disclose on the responsible ownership activities that are being undertaken on their behalf. We encourage asset owners to report on all relevant responsible ownership activities that are being undertaken on their behalf.
- On informed voting, there are generally two common practices (i) institutional investors that disclose their vote instructions ahead of the AGM and (ii) those that reserve that until (immediately) after the AGM. However, apart from the timing of the disclosure, it can be seen as best practice that institutional investors have appropriate historical records of all their voting, on each company and agenda item that they voted. Increasingly institutional investors give an explanation, especially when they do not follow the vote recommendation given by the company. We recommend that disclosure of voting is embedded as best practice in the Hong Kong market.
- On other responsible ownership activities, such as dialogue and/or engagements, we see an emerging best practice of informative reporting on these activities depending on the event, materiality and/or whether the disclosure is appropriate at that point in time. The most advanced institutional investors have adopted a regular practice of providing annual reports on their responsible ownership activities. We recommend that regular reporting on responsible ownership be regarded as best practice in the Hong Kong market as well.
- Pension funds (asset owners) tend to disclose more and with greater sophistication on their ownership activities than other institutional investors. We also see a similar quality divergence between the larger asset managers and the smaller asset managers. There are important exceptions however and we believe that quality distinctions between types of investors should not be taken as a market norm. Indeed, we encourage asset owners and asset managers, regardless of their scale, to adopt strategies of continuous improvement when the Principles come into effect.
- Finally, please be informed that some of our Investor Members have indicated to us that they would be more than willing to provide specific examples of what they consider to be best practices on disclosure on responsible ownership activities.

14) Views on policy objectives: (i) sense of ownership; (ii) linking engagement to investment process; (iii) improved communication between boards and investors; (iv) disclosure for clients

- We believe that all of the policy objectives cited are not only timely but also material to the Hong Kong market. In particular, as noted in our overall comments, we believe that improvement in Hong Kong's governance climate rests on more robust and engaged communication between boards and investors. Proper

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818

execution of the ownership duties, risk management, and long-term value-creation obligations which face both company boards and investors must be informed by real and constructive dialogue as well as a more realistic understanding of value drivers for Hong Kong's market.

15) Monitoring implementation of the Principles

- The implementation of the Principles should be assessed annually in a high level report prepared by the SFC (in the absence of a regulator in Hong Kong equivalent to the UK FRC). Material should be assembled in an orderly way on the SFC website to permit stakeholders to review the information in an efficient way.
- As above, the UK FRC has undertaken annual review of the disclosures made under the UK Stewardship Code and published the findings. The SFC may wish to make reference to this process, and consider whether to adopt a similar approach for Hong Kong.

Thank you for your attention. We would be pleased to discuss the above issues in further detail.

Yours sincerely,

Gerard Fehrenbach
Acting Secretary General

© ACGA Ltd, 2015

ASIAN CORPORATE GOVERNANCE ASSOCIATION
Room 1801, 18th Floor, Wilson House, 19-27 Wyndham Street, Central, Hong Kong Tel 852 2160 1788 Fax 852 2147 3818