

March 27, 2023

**Hong Kong Exchanges and Clearing Limited**

8<sup>th</sup> Floor, Two Exchange Square  
8 Connaught Place  
Central, Hong Kong

**Re: Our response to HKEX's consultation paper on "Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers"**

Dear Sir/Madam,

BlackRock<sup>1</sup> welcomes the opportunity to respond to the Consultation Paper "Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers" (Consultation Paper)<sup>2</sup>, issued by the Stock Exchange of Hong Kong Limited (Exchange) on February 24, 2023.

BlackRock supports a regulatory regime that increases transparency, protects investors and facilitates responsible growth of capital markets. We appreciate this opportunity to comment on some of the proposed amendments in the Consultation Paper and seek to contribute to the discussion to help shape a final outcome that balances and protects the interests of all relevant stakeholders.

We have responded to the specific questions raised in the Consultation Paper. We would, however, take this opportunity to provide our views on the amendments to Chapter 19A to remove the class meeting and related requirements for issuance of new shares and repurchase of existing shares by PRC issuers, which the Exchange has described as consequential in nature and thus not subject to consultation. As a fiduciary for clients whose assets we manage, we consider these amendments to pose significant potential impact to the interests of investors in H shares listed on the Exchange which will result in these shares being less attractive investments for long term shareholders. They also have negative implications for A share investors in the mainland China markets as well.

While acknowledging that the proposed rule amendments to repeal the class meeting requirements are consequential to the changes in PRC regulations, we are concerned about the impact of these changes on proposals with potentially inequitable outcomes for A shareholders and H shareholders. These stem from the lack of fungibility of A shares<sup>3</sup> and H shares and will also potentially have unintended implications for minority shareholder protection. Even with the proposed rule amendments, we suggest the Exchange consider providing guidance that, based on the companies' current articles, the required amendments to articles of association for the removal of separate class meetings should itself be approved through separate meetings for A shareholders and H shareholders. The

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<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

<sup>2</sup> HKEX. "[Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers](#)," February 2023. Unless otherwise indicated, the terms used in this letter shall mean the same as in the Consultation Paper.

<sup>3</sup> While A shares are a subset of domestic shares, they do not include domestic shares unlisted on the A share markets, which have become partly fungible with H shares through the H share full circulation scheme.

Exchange could also consider consulting the market to formulate a list of proposals that may potentially have inequitable impact to the interests of shareholders of A shares and H shares. Even as both A shares and H shares are deemed as one class of shares, by these rule amendments of the Exchange, separate meetings will continue to be required for proposals that involve delisting; similarly, we recommend that other proposals which may potentially have inequitable impact on the interests of the two groups of shareholders should also continue to require separate meetings. We provide some other recommendations in the latter section of this response.

## **Class meeting requirements and shareholder protection**

As an institutional investor managing US\$8.6 trillion as at December 2022 for a wide array of clients including public pension funds and other long-term investors, BlackRock firmly believes in the “one-share, one-vote” (OSOV) principle as the foundation for protecting the rights of all shareholders on an equitable basis. Our starting point is therefore that we agree there should not be share classes with equivalent economic exposure, but where one class enjoys preferential and differentiated voting rights relative to other classes, as this violates the fundamental corporate governance principle of proportionality and results in a concentration of power in the hands of a few shareholders. Indeed, in the context of the H share full circulation scheme, under the current class meeting requirements there could be hypothetical scenarios where domestic shareholders could retain veto power on proposals by retaining only a very small ownership and even just one domestic share, which would be viewed as disproportionate for H shareholders. We note that the basis for removing class meeting requirements, as explained by the Exchange in the Consultation Paper, is that domestic shares and H shares, which are both ordinary shares, will no longer be deemed to be different classes of shares following the repeal of the Special Regulations and the Mandatory Provisions by the regulators in China.

However, as we state in BlackRock Investment Stewardship Global Principles<sup>4</sup>, we recognize that in certain markets there may be a valid argument for listing dual classes of shares with differentiated voting rights. We consider that for issuers that are dual listed in both the A share and the H share markets, there are considerations that would, on balance, justify requirements for differentiated voting rights.

A key feature of A shares and H shares is that they are non-fungible and trade on markets that, today, still have very different characteristics. Despite the mutual market access provided through Stock Connect, the Exchange and the onshore exchanges have very different investor profiles, and A shares and H shares often trade with significant divergence in their traded share prices.<sup>5</sup> A shareholders and H shareholders are also subject to different regulatory regimes. Although both A shares and H shares are ordinary shares that carry the same substantive economic rights such as dividends and asset distribution on liquidation, however, in practice some proposals may benefit only one group of shareholders, sometimes at the expense of the other group. We have seen that in certain circumstances this has resulted in inequitable outcomes for the two groups of shareholders. Accordingly, while technically H shares and A shares will be considered the same class of shares under PRC law, the practical reality remains that they will continue to be traded as different securities on separate exchanges.

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<sup>4</sup> See [BlackRock Investment Stewardship Global Principles](#).

<sup>5</sup> For example, see a track record of the absolute price premium (or discount) of A shares over H shares for the largest and most liquid mainland China companies with both A-share and H-share listings measured by the [Hang Seng Stock Connect China AH Premium Index](#).

## Inequitable outcomes in rights issues

In our experience, rights issuance in both the A share and the H share markets could result in potentially unequal outcomes and thus deemed to be unfair to H shareholders. For share placements, pricing is benchmarked against respective A share price or H share price; however, the subscription price for rights issuance is required to be set the same across A shares and H shares. As H shares are most often traded at a discount to A shares, sometimes as high as 50%, A shareholders are often offered a much deeper discount to share prices than H shareholders to subscribe for the rights shares.<sup>6</sup> We have also observed cases where the issuance price was even set above the H share price, thus H shareholders had no economic incentive to participate in the issuance while A shareholders were able to subscribe newly issued shares at a discount to the A share traded price. If the issuance price was set at a discount to book value, H shareholders as a group would be faced with a dilution of book value per share. In practice, as the A shares adjust to the ex-rights price, the percentage discount for the H shares generally remains, which results in the H shares adjusting down with no compensation for H share investors.

### Case study: Orient Securities

In March 2021, Orient Securities (600958-CN/3958-HK) proposed the issuance of A shares and H shares by way of rights issue, to raise up to RMB16.8 billion.<sup>7</sup> After obtaining shareholder approval, the rights issue was conducted on the basis of 2.8 shares for 10 existing shares, at a subscription price that was the same for both A shares and H shares (i.e. RMB8.46 per A share or HK\$10.38 per H share, exchange-rate adjusted).<sup>8</sup> This subscription price was lower than the unaffected A share price (RMB10.88) but significantly above the unaffected H share price (HK\$4.86). As such, 89.96% of eligible A shareholders participated in the issuance,<sup>9</sup> while only 0.03% of eligible H shareholders participated.<sup>10</sup> The issuance led to EPS dilution of 17.7%. On the next trading day following the ex-rights date, the H share price of the issuer fell 13.2% compared with the previous trading day while Hang Seng Index was essentially unchanged (up by 0.06% for the day).

We note the Securities and Futures Commission (SFC)'s Takeovers Code requires that "where a company has more than one class of equity share capital, a comparable offer must be made for each class". For example, when an offer is made for the A shares of a dual-listed company, a comparable H share offer must be made contemporaneously, and the calculation of the offer price for the H shares would include an adjustment based on the ratio of H share price to A share price.<sup>11</sup> The offer received by H shareholders would thus in general be at a discount to the offer to A shareholders. According to the SFC's Practice Note (PN25) issued on 17 March 2023, this separate treatment of A shares and H shares will be maintained despite the regulatory updates in China.<sup>12</sup> It appears that H shareholders are in a disadvantageous position in both circumstances: where they are entitled to an offer to dispose their shares it would be at a lower price than A shareholders, but when they are offered to subscribe for a rights issue it is at the same price as the subscription price offered to A shareholders, i.e. the rights subscription price would be at a much smaller

<sup>6</sup> Since there is no limit on discount for rights issuance, we have observed cases where the discount to A share prices could be as high as 60%. In contrast, the maximum discount for A share private placement is 20%.

<sup>7</sup> Orient Securities, [Company Disclosure](#), March 2021 Orient Securities, [Company Disclosure](#), March 2021

<sup>8</sup> Orient Securities, [Company Disclosure](#), May 2022

<sup>9</sup> Orient Securities, [Company Disclosure](#), April 2022 Orient Securities, [Company Disclosure](#), April 2022

<sup>10</sup> Orient Securities, [Company Disclosure](#), May 2022

<sup>11</sup> SFC, [Practice Note 25 \(PN25\) – Guidance Note on the application of the Codes on Takeovers and Mergers and Share Buy-backs \(Codes\) following the abolition of the Special Regulations and the Mandatory Provisions and other matters relating to offers for A and H shares of a listed issuer](#), 2023.

<sup>12</sup> As above.

discount to the traded H share price relative to A shares and sometimes at a premium to the H share traded price. The fairness of each individual proposal might be debatable. However, given the quite likely inequitable economic outcomes, we believe shareholders of A shares and H shares each as a group should be entitled to vote separately to decide whether a proposal is favorable for them as shareholders.

## **Inequitable impact to shareholders in spin-offs**

The provision of pre-emptive rights in a spin-off represents another form of potentially inequitable treatment to shareholders. On the one hand, the Listing Rules require provision of pre-emptive rights to subscribe shares of the spun-off entity to existing shareholders; on the other hand, there are legal and regulatory barriers for A shareholders to the pre-emptive rights of a spun-off entity seeking overseas listing.<sup>13</sup> As a result, companies would typically submit a proposal to provide pre-emptive rights to H shareholders only, which in this case is unfair treatment to A shareholders relative to H shareholders. While not clearly mandatory,<sup>14</sup> historically, we have observed companies submitting these proposals to class meetings for separate approval by A shareholders and H shareholders. Some of these proposals were voted down by A shareholders. Upon removal of the Mandatory Provisions and class meeting requirements, both A and H shareholders will no longer have the ability to prevent proposals that may be deemed inequitable to one or other of the two groups of shareholders.

### **Case study: Ping An Insurance**

In March 2018, Ping An Insurance (Group) Company of China (601318-CN/2318-HK) held an extraordinary general meeting and class meetings for A shareholders and H shareholders, where shareholders were to vote on the resolution regarding the provision of entitlement to H shareholders only for the overseas listing of Ping An Healthcare and Technology Company Limited (“Ping An Good Doctor”). Despite 73.7% shareholder support at the general meeting and 99.6% support at the H shareholders’ class meeting, the proposal was voted down as 84.0% of A shareholders voted against it at the A shareholders’ class meeting.<sup>15</sup>

## **Varying impacts from shareholder distribution decisions**

The entitlement of A shares and H shares are fundamentally different, and the economic impact of proposals could be quite different, even if these are designated as the same class of shares. As a further illustration, rights received by A shareholders in rights issuance are not transferrable under PRC regulation, whereas those received by H shareholders are, i.e., H shareholders can sell the rights in the market if they decide not to participate in the share issuance (assuming the rights carry a positive value) while A shareholders are not able to. A key aspect of property rights, A shares and H shares carry different rights to transfer since

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<sup>13</sup> For example, see Ping An Insurance (Group) Company of China. [\(1\) PROPOSED PROVISION OF ASSURED ENTITLEMENT TO THE H SHAREHOLDERS ONLY FOR THE OVERSEAS LISTING OF PING AN GOOD DOCTOR AND \(2\) PROPOSED AMENDMENTS TO THE ARTICLES OF ASSOCIATION](#). 2018.

<sup>14</sup> While the Listing Rules only require class meetings for proposals that involve share issuance and repurchase, the Mandatory Provisions are principle-based and include a non-exhaustive list of proposals that would vary or abrogate the rights attached to A shares or H shares and thus require class meeting approval.

<sup>15</sup> Ping An Insurance (Group) Company of China. [VOTING RESULTS OF THE 2018 FIRST EXTRAORDINARY GENERAL MEETING, THE 2018 FIRST A SHAREHOLDERS’ CLASS MEETING AND THE 2018 FIRST H SHAREHOLDERS’ CLASS MEETING HELD ON MONDAY, MARCH 19, 2018](#). 2018.

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they are not fungible and hence can only be sold in their respective markets. This leads to divergence in share price formation and shareholder interests.

The divergence of interest is evident also in the comparison between dividend and bonus shares. Consider a company dual listed in both A share and H share markets, whose H shares accounted for 20% of total (A and H) shares outstanding, possibly trading at a 50% discount to A shares. If the company decides to return capital to shareholders through a cash dividend, H shareholders would receive the same amount of cash per share as A shareholders. However, if it chose to provide shareholders with bonus shares, H shareholders would receive only half the value compared to A shareholders. Both cash dividend and bonus shares treat all shareholders equally in principle, but they entail different patterns of distribution of value in such situations, as evident in the difference in the calculation of ex-entitlement prices.<sup>16</sup> This difference derives from H shareholders in this example being entitled to 20% of the company's net asset value, but H shares accounting for only 11% of the market capitalization. Thus, value is distributed differently among A shareholders and H shareholders depending on the form of distribution chosen by management.

## Case study: Bank of Zhengzhou

At its FY 2020 annual general meeting, Bank of Zhengzhou (002936-CN/6196-HK) proposed to suspend its cash dividend and only to issue bonus shares at a ratio of 1:10. This profit distribution plan was combined into one special resolution voted by way of class meetings. 35.1% of the H shares presented at the annual general meeting opposed the resolution (as compared to only 10.7% from A shares).<sup>17</sup> The profit distribution plan failed to pass as it did not obtain the required two-third level of support at the H shareholders' class meeting.

## Equalizing voting power leading to potentially inequitable outcomes

Currently, class meetings provide a mechanism for A shareholders as well as H shareholders to each have a veto on proposals that may result in different economic outcomes for them and hence may be considered inequitable. Equalizing voting power by removing the class meeting requirements would undermine shareholders' ability to vote down potentially inequitable proposals to one group between the A shareholders and H shareholders. We believe these fairness concerns justify maintaining existing requirements for separate approval of certain proposals by A shareholders and H shareholders. We consider it an important role for the regulator, in protecting the interests of investors, to enable H shareholders as well as A shareholders to vote separately on these proposals to ensure they are seen to be equitable and reasonable to both sides.

We appreciate that the Exchange has proposed to retain Listing Rule 19A.12 requiring H shareholders' approval for a withdrawal of listing on the Exchange. By SFC's explanation in its guidance<sup>18</sup> in light of new Mainland rules for overseas listings, "[a] take-private offer or a delisting proposal of the H shares for a PRC H Share Issuer [...] affects the interests of its

<sup>16</sup> For ex-dividend adjustment, an absolute amount of dividend per share is subtracted from share prices. For bonus shares, share prices are divided by a factor based on the percentage increase in issued shares, with different absolute adjustment based on previous closing prices of A shares and H shares.

<sup>17</sup> Bank of Zhengzhou Co., Ltd. [POLL RESULTS OF 2020 ANNUAL GENERAL MEETING, 2021 FIRST A SHAREHOLDERS CLASS MEETING AND 2021 FIRST H SHAREHOLDERS CLASS MEETING](#). 2021.

<sup>18</sup> SFC. [SFC issues guidance in light of new Mainland rules for overseas listings](#). 2023.

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holders of H shares *to a much larger extent* compared to its other shareholders”,<sup>19</sup> and this justifies the preservation of the requirement for separate class approval from H shareholders for delisting of H shares. We believe SFC’s arguments for separate treatment of A shares and H shares for de-listing proposals should similarly apply to various other types of proposals. For various proposals described above, the rationale provided by the SFC, i.e. “the inherent differences in the trading prices and currencies of, and the markets for, A shares and H shares of PRC H Share Issuers, and the fact that A shares and H shares are not directly fungible”<sup>20</sup> is equally applicable. The extent of the impact should not be a qualification to the principle that where proposals could have inequitable consequences for A shareholders and H shareholders given the lack of fungibility in these shares, the interests of each group of shareholders requires that they be voted on separately.

The issues under consideration are unique in the international context. Differentiating share classes by listing market is not a typical practice in other markets; however, the lack of fungibility between A shares and H shares is a unique feature in the global context. The concerns above fundamentally stem from this unique feature and warrant a unique solution, for instance that each group of shareholders of A shares and H shares respectively having to approve certain proposals that may not treat them equitably, as has been the practice to date. Following the repeal of the distinction between domestic shares and H shares as different “classes” of shares, we urge the Exchange to consider and introduce alternative measures for issuers with equities traded on both A share and H share markets to safeguard the interests of all shareholders against potential inequitable treatment.

## **Class meeting requirements: minority shareholder protection**

We are also concerned that minority shareholder protection and thus the interest of our clients, who invest in PRC issuers as minority shareholders, could be undermined as an unintended consequence of the proposed rule amendments.

Since 1993, the class meeting requirements have given a veto to H shareholders, in most cases minority shareholders, on significant capital decisions around the issuance and repurchase of shares. To gain support from H shareholders, PRC issuers are incentivized to design and implement proposals in a way that can be supported by both A and H shareholders. Poorly structured proposals by the management and/or controlling shareholders, who are mostly A shareholders, could be voted down by H shareholders despite a minority stake, and vice versa. International investors have been investing in H shares on the understanding that they will be protected from A share controlling shareholders by the class meeting requirements. While the rule amendments are intended to reflect regulatory changes in China, an unintended consequence of the repeal of class meeting requirements is a likely weakening of minority shareholder protection.

Following this proposed repeal of separate meetings for A and H shareholders, there are concerns whether the controlling shareholders of PRC issuers would consider decisions around share issuance differently from financial investors. As many of the companies dual listed in the A share and the H share markets are state-owned enterprises, controlling shareholders may have quite different priorities and considerations from financial investors. Minority shareholders would thus be exposed to a higher risk that key decisions involving share issuance may not prioritize long-term shareholder value following the

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<sup>19</sup> SFC. [Practice Note 25 \(PN25\) – Guidance Note on the application of the Codes on Takeovers and Mergers and Share Buy-backs \(Codes\) following the abolition of the Special Regulations and the Mandatory Provisions and other matters relating to offers for A and H shares of a listed issuer](#). 2023.

<sup>20</sup> As above.

## Case study: Shanghai Fosun Pharmaceutical (Group) Co., Ltd.

At its 2020 Annual General Meeting, Shanghai Fosun Pharmaceutical (Group) Co., Ltd. (600196-CN/2196-HK) proposed adoption of the 2021 restricted share incentive scheme, by which 2,407,200 Restricted Shares would be granted to 88 participants at RMB22.58 per share over several tranches conditional upon performance targets being met.<sup>22</sup> In this scheme, director(s) eligible for the shares were also involved in the administration of the scheme, which may have raised shareholder concerns.<sup>23</sup> The support rate from H shareholders for this proposal was 42%, below the two-thirds support rate required for special resolutions, hence the resolution did not pass.<sup>24</sup>

## Potential impact on minority shareholder interests

It is important to note that an assessment of the impact of the repeal of class meeting requirements on issuer behavior cannot be measured by the level of prevalence of poorly structured proposals *before* the regulatory updates. While proposals being voted down by H shareholders at class meetings have not been frequent, this may be a result precisely of the class meeting requirements. Removing the mechanism for H shareholders to oppose proposals could reduce the incentive for PRC issuers to consider minority shareholders and may lead to changes in issuer behavioral pattern that could be detrimental to minority shareholder interests. Class meeting requirements also incentivize PRC issuers to heed H shareholders' views based on international standards of corporate governance. The process of absorbing global best practices on governance will likely be weakened following these regulatory changes.

While class meeting was introduced initially to offer extra protection to H shareholders, it has served as a general minority shareholder protection mechanism as well. In general, reduced protection for minority shareholders may diminish the attractiveness of investments. We recommend the Exchange consider introducing new measures to preserve this element of minority shareholder protection despite the repeal of class meeting requirements. This will preserve the current level of shareholder protection in the H share market, maintain its attractiveness to international investors, and secure the foundations for the long-term development of the H share market.

## Recommendations on next steps

While acknowledging that the proposed rule amendments to repeal the class meeting requirements are consequential to the changes in PRC regulations, following these proposed amendments, we suggest the following for the Exchange as the front-line regulator to consider the following:

- Provide guidance to clarify that an issuer may opt to preserve the class meeting arrangement if already in its articles of association, as the Listing Rules no longer require but do not forbid class meetings even after this change.

<sup>21</sup> We acknowledge that the misalignment of agenda and priorities between controlling shareholders and minority shareholders is by no means an issue specific to PRC issuers, but it demonstrates that minority shareholder protection could be undermined by the repeal of class meeting requirements despite dilution impact being the same to all shareholders.

<sup>22</sup> Fosun Pharma, [Company Disclosure](#), May 2021 Fosun Pharma, [Company Disclosure](#), May 2021

<sup>23</sup> Institutional Shareholder Services, [Hong Kong Voting Guidelines](#)

<sup>24</sup> Fosun Pharma, [Company Disclosure](#), June 2021

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- Provide guidance that an issuer in submitting amendments to its articles of association for the removal of class meeting requirements, should have this approved by separate class meetings for A shareholders and H shareholders as has been stipulated in the Mandatory Provisions and incorporated in their existing articles of association (as long as their current articles of association do not prevent them from doing so).
- Formulate, after consulting the market, a list of proposals that may have potentially inequitable impact to the interests of A shareholders and H shareholders and, until such time in the future that A shares and H shares may become fungible, to require separate approval by A shareholders and H shareholders for these proposals while recognizing that both groups are shareholders of the same class of shares in terms of economic rights.
- Introduce measures of shareholder protection for minorities in both the A share and H share markets to maintain a similar level of protection for shareholders of PRC issuers, and potentially apply these measures to all issuers if there is a felt need for a consistent regulatory approach across other issuer jurisdictions.
- Require companies to provide an analysis of voting results of A shareholders and H shareholders separately, and if a company were to proceed with a proposal that would previously have been blocked by either group of shareholders, to provide a statement explaining why this is in the interests of all shareholders.

## Conclusion

The essential feature of lack of fungibility of A shares and H shares results in potentially divergent outcomes for each group of investors from a given set of proposals. Before the shares potentially become fungible in the future, international investors will continue to consider them differently. We believe the removal of separate class meetings for A shareholders and H shareholders is a removal of protection to both group of shareholders, which could significantly impact their rights and potentially result in inequitable outcomes. There have been various cases in recent years where A or H shareholders have voted against proposals and thus prevented inequitable outcomes. While the A share market has seen considerable advances in its regulatory framework, minority shareholders of H shares would no longer be able to effectively prevent certain proposals that are poorly structured and would generally be carried with the removal of the class meetings moving forward.

Thus, we urge the Exchange to consider, if A shares and H shares are to be deemed as the same class of shares, that other measures, including some suggestions provided above, be introduced to give similar protection to investors in the Hong Kong market. As always, we would welcome the opportunity for any further discussion on this matter.

Yours sincerely,

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Susan Chan  
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