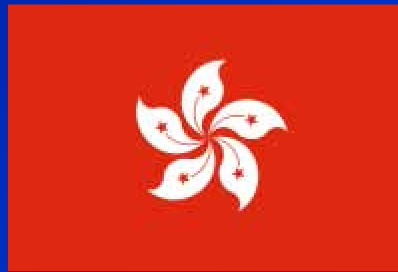
# Shareholder Rights in HK: a status report



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# Reporting speed – a study in slowness

- The older the published information, the less it is worth, and the greater the asymmetry between insiders and outsiders
- 11-Dec-98: SEHK proposes full-format interim results within 2 months, annual results within 3 months
- Settles on shortening deadline for annual results from 5 months to 4 months, interims unchanged (3 months), but adding condensed balance sheet and cash flow statements.
- 1999: GEM launches with 45 day-deadline (2 quarters & interim) and 3 months (annual) respectively
- 31-Aug-07: SEHK proposes 2 months for interims, 3 months for annuals
- 18-Jul-08: SEHK decides this will happen, but only for half-years ending 30-Jun-10 and annuals ending 31-Dec-10 or after
- 12 years for so little progress! Singapore companies report annual results within 60 days. At this rate, we may catch up by 2022.

# Poll voting

- In 2003, I launched "Project Poll" to force all HK blue chips to vote by poll
- Bought 3 BVI shell companies, 10 shares in each HSI member (plus HKEx), and split them into 5 registered holdings – three BVI companies, me and my wife
- Successfully demanded poll votes on behalf of the 5 shareholders. This eliminated resistance to change from the most influential companies in HK
- 31-Mar-2004: Poll voting becomes mandatory for connected transaction votes and others where a controller is required to abstain, but not for other votes
- 1-Jan2009: poll voting becomes mandatory for all votes - mission accomplished!
- BUT: ongoing problem: banks, brokers and other intermediaries do not have to seek voting instructions for the shares they hold. So retail investors are usually absent from the vote count. They hold about 40% of the float, and much more in small companies. This facilitates controller abuse.
- Checks and balances fail if owners cannot practically vote
- The SFC should require all intermediaries to seek voting instructions!
- The cheapest way to do this is to open a Stock Segregated Account in CCASS for each client, and let them input votes using the online system.

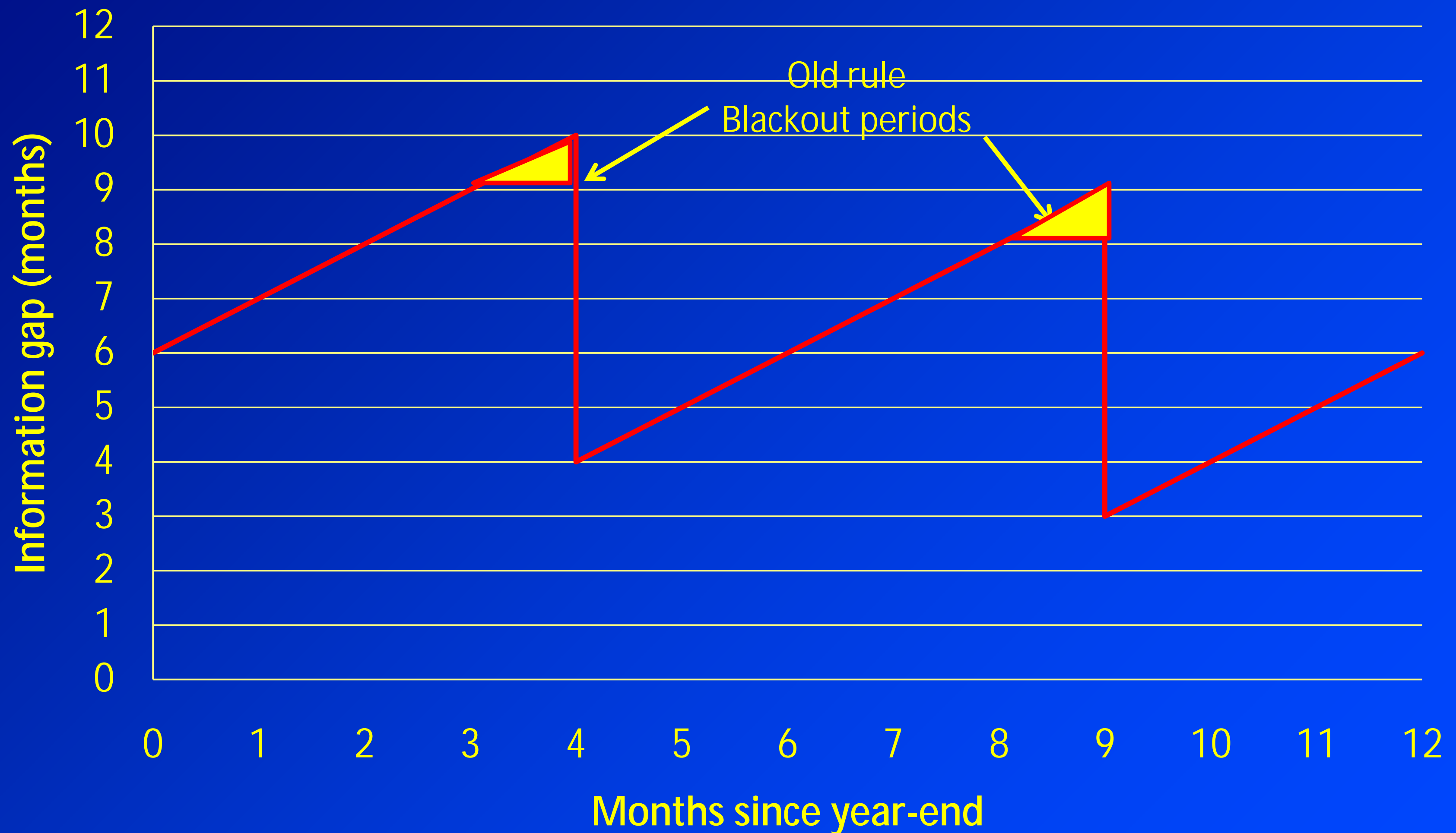
# INEDs

- Most markets require independent non-executive directors, but only in name
- If the controlling shareholder can vote on INED elections, then the INEDs are dependent on the controller, not independent of it
- Consequently INEDs are often just rubber stamps
- No regulator I know of has yet addressed this problem
- Independent directors should be elected by independent shareholders. Controlling shareholders and other directors should be required to abstain
- Boards could still nominate candidates,  but candidates would have to be acceptable to independent shareholders
- INEDs would have a mandate, and be held accountable at the next election
- Failing that, we should scrap the requirement for INEDs rather than provide false comfort, and let listed companies decide whether they want their boards to be credible or not

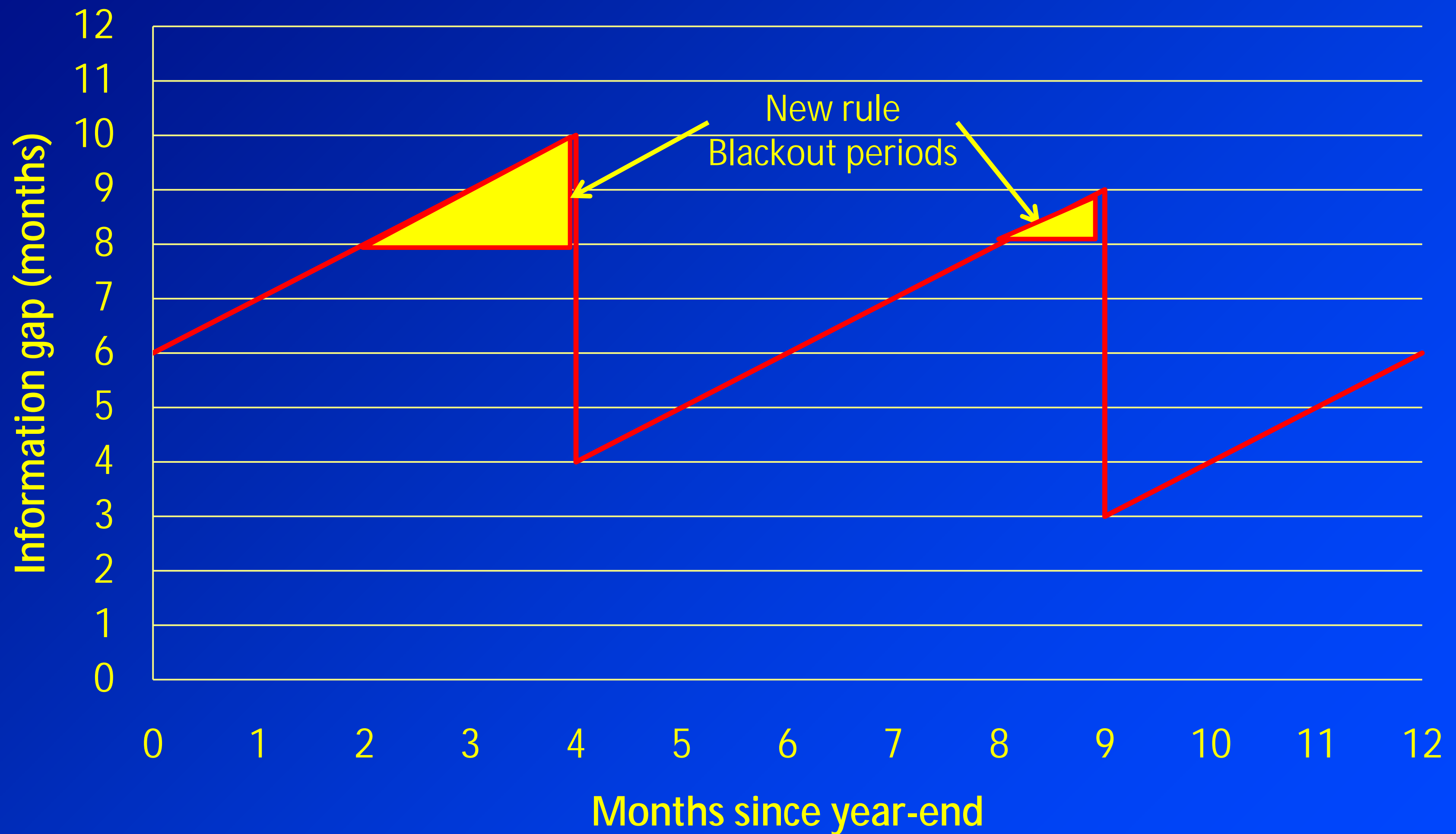
# The blackout saga, 2008-09

- The old rule:
  - No insider dealing one month before results
  - Insiders decide when to announce results, up to 4 months after the year end or 3 months after the half-year end
  - The later the results, the more time insiders have to deal on the information advantage
- The revoked new rule (was due 1-Jan-09):
  - No dealing from the year-end or half-year end until you announce your results
  - The faster results are published, the more time insiders have to deal each year
- The amended new rule, 1-Apr-09 (not a joke)
  - Same as the old rule
  - except that the blackout for year-end results starts 2 months before you announce
  - The later you announce, the more time you have for insider-dealing

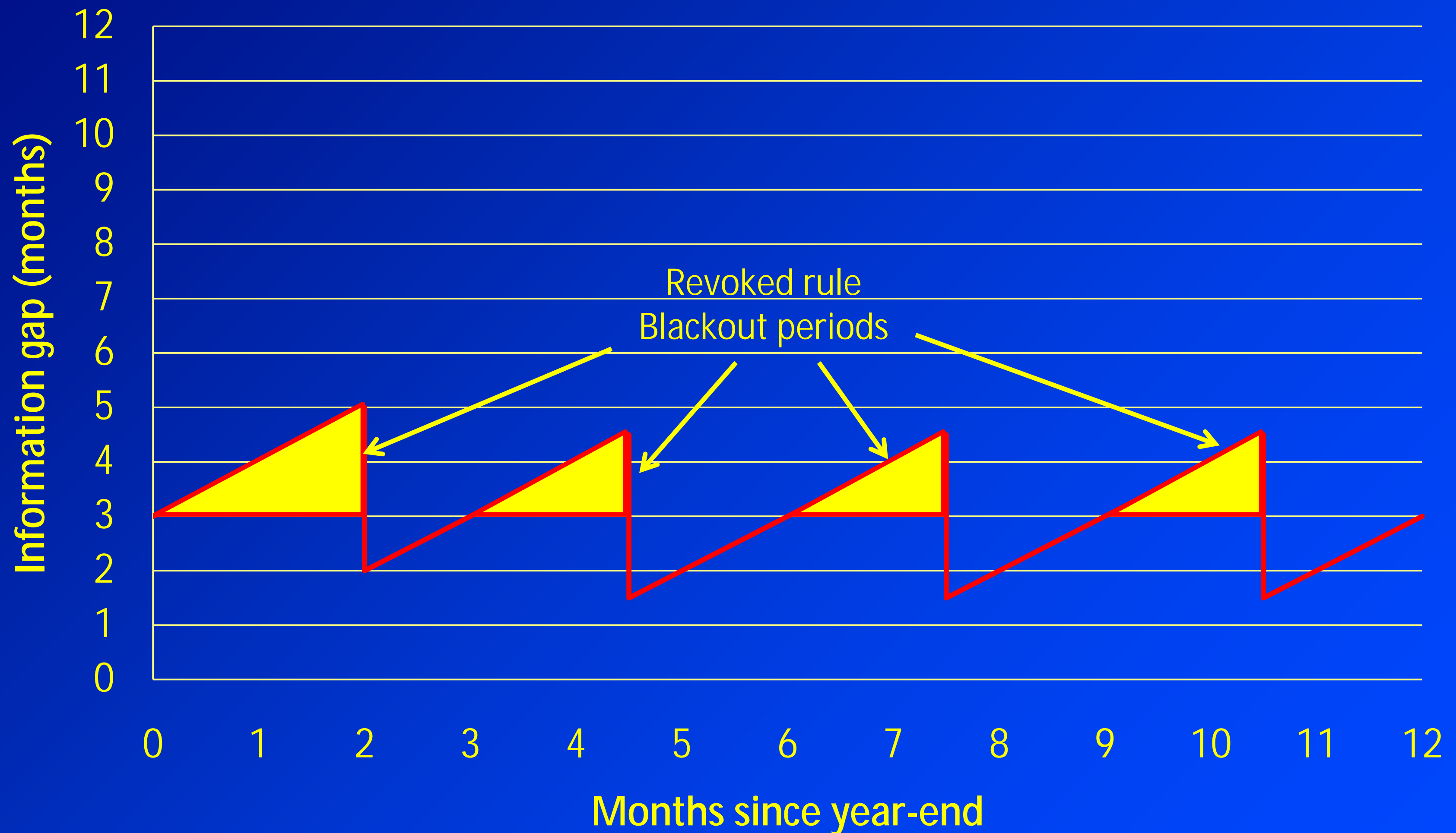
# Insider-outsider information gap for a company reporting at the deadlines



# The amended new rule – almost no change



# What is achievable: frequent, fast disclosure, shorter blackouts



## They spin

- The blackout "creates a window of opportunities for corporate snipers to destroy value for both major and small shareholders"
- The blackout "discourages talented individuals of the right caliber from becoming directors"
- There are laws against insider dealing on inside information. So we don't need the blackout rule. Catch us if you can.

## We say

- Most companies have controllers, with no risk of hostile takeover. Value is created or destroyed by management, not by shareholders.
- Dealing on inside information is not meant to be a perk of the job. Directors should invest for the long term and will have ample opportunities to do so.
- There are laws against death caused by dangerous driving. We still need laws against speeding. Information advantage is hard to prove beyond reasonable doubt. Dealing in the blackout period is a clear test.

# Pre-emptive rights

- With annual general mandate, controlling shareholders who run co can hand a 20% discount on a 20% stake to selected parties
- UK best practice: 5% in 1 year at 5% discount, 7.5% in 3 years
- Project VAMPIRE – Vote Against Mandate for Placings, Issues by Rights Excepted (2003)
- Thanks to poll voting, we know that independent holders vote against the mandate by more than 2:1, and have vetoed it in companies with low or no controlling holder
- So HKEx dare not seek a mandate itself
- HK also allows open offers at any discount and up to 50% issue size without minority approval. Non-transferable offer, so take up or be diluted to hell.
- HK also allows "specific mandates" of any size and discount, without minority shareholder approval.
- UK Listing Rules: 10% discount limit, otherwise rights must be tradable

# Bad governance: missing deterrent

- Regulatory "name and shame" (Listing Rules) – minimal deterrent effect
- Civil tribunal - disgorgement of profits & legal expenses. Probability of being caught is less than 100%, so not a big deterrent
- Criminal prosecution – fines and jail, but need proof beyond reasonable doubt rather than balance of probabilities
- Tribunal/criminal route depends on government bringing the action. With limited resources, few cases are brought
- Derivative actions: benefit goes to company, which might still be abused by the same defendants. Costs are still an issue until court awards expenses from company. So this route has not yet been used
- Shareholders could sue, but cost is prohibitive to each shareholder, and joint action is hard to coordinate. Those who don't participate get a free ride.
- So there is a missing element to the deterrent system
- How to facilitate shareholder litigation?

# SCALP

- Shareholder Class Action, Loser Pays
- Judge decides whether to allow case as a class action
- Class members can opt out of the action, otherwise they are bound by it
- Loser pays costs (as at present), so frivolous actions are deterred
- Only viable if the representative plaintiff does not have to give the class a free ride on the downside (costs)
- So we need Litigation Funding Companies & contingent legal fees
- Laws against champerty & maintenance should be abolished
- Class actions would add a private-sector deterrent to bad governance, thereby reducing it
- Australia has had class actions for 20 years. LFCs are now listed
- HK Law Reform Commission has published consultation paper on the way forward
- System could apply to any case, including consumer actions

And now, a few words from today's sponsors…

# HKICPA's role in reform

- Quarterly financial reporting was suggested by SEHK in 1998, formally proposed in 2002 and 2007, and abandoned twice, leaving HK lagging most Asian markets
- Mandatory on GEM since 1999 launch, and mandatory in mainland China since 2002
- HKICPA in 2002 submission
  - "quarterly reporting should be a mandatory rather than a voluntary measure…quarterly reporting encourages greater transparency and provides more timely financial information to shareholders and the market"
- HKICPA in 2008 submission:
  - "we do not consider that it would be appropriate to introduce mandatory quarterly financial reporting in Hong Kong…it would potentially make Hong Kong's market less competitive"
- In their 2008 submissions, of the big 4, E&Y and Deloitte supported QFR, KPMG expressed neutrality, and only PwC opposed
- HKICPA opposed mandatory poll voting (2008)
- HKICPA opposed extension of the blackout period because "it could give a misleading signal to directors, that it would be safe to trade in their company's shares during the non-black-out periods" (2008)

# HKICS role in reform

- "We do not find it necessary to require the voting of all resolutions at either general meetings or annual general meetings to be by poll" (21-Apr-08)
- "We find this proposed extension [of the blackout period] unnecessary" (21-Apr-08)
- "We indicated in 2002 that we were against quarterly reporting. Our stance on this issue remains the same." (5-Nov-07)
- "The institute would not be prepared to support a comprehensive scheme for multi-party litigation unless..." (no to opt-out, no litigation finance, no legal aid, no class action fund) (3-Feb-10)

# Ernst & Young – *Quality in Everything We Do*

- IPO reporting accountants of:
  - Gold Wo International Holdings (2001)
  - Fu Cheong International Holdings (2002)
  - Global Trend Intelligent Technologies (2003)
- Directors of the above were jailed for accounting fraud
- auditors of Akai Holdings Ltd (a rare case of both litigation funding and a successful claim against an auditor, settled after allegations of evidence tampering)
- But they do support mandatory quarterly financials!

# Other reform issues in HK

- Listing Rules remain toothless - Statutory backing was proposed twice, watered down and now due for another consultation.
- Location of Listing Regulator – we have a for-profit regulator, which is a conflict of interest. The SFC should take this over (Expert Group, 2003)
- Scripless registration of shares – on the drawing board since 1998, now under consultation again. Consequently most shareowners have no legal rights
- Lack of duty of care from auditors to shareholders (*Caparo*, 1990). We need a statutory duty of care to investors and creditors. *Ex turpi causa non oritur actio* tends to protect auditors from claims from the company
- Abolishing the head-count in schemes of arrangement (PCCW!) – something we can all agree on?
- Proposals abandoned by SFC in 2006:
  - right to rely on prospectus for purchases in the secondary market
  - abolition of requirement to prove that you read a prospectus before you can sue on it

# Thank you!

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