



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on the Principles of Responsible Ownership

7 March 2016

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Executive Summary

1. On 2 March 2015, the Securities and Futures Commission (**SFC**) issued the Consultation Paper on the Principles of Responsible Ownership (**Consultation Paper**) for public consultation which ended on 2 June 2015. The Consultation Paper invited comments on the introduction of the Principles of Responsible Ownership (**Principles**) with the aim to provide guidance on how investors should fulfil their ownership responsibilities in relation to investments in Hong Kong listed companies.
2. In preparing this paper and forming consultation conclusions, the SFC took into account all submissions received. In total, the consultation conclusions took into account submissions from 56 respondents which comprised various market participants and professional bodies. Respondents included 11 asset management firms, eight individuals, three law firms, 10 Hong Kong listed companies and 17 societies or associations.
3. The SFC has thoroughly considered all responses and comments and has modified the Principles outlined in the Consultation Paper accordingly. The Principles will be introduced with the following main features:
 - (a) the Principles are voluntary and open for investors to adopt;
 - (b) the Principles are intended to apply to investors who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders;
 - (c) investors who hold or receive funds from the public that are invested in shares of Hong Kong listed companies are encouraged to adopt the Principles and disclose to their stakeholders in accordance with the Principles;
 - (d) investors who do not think that the Principles are relevant or suitable for them are encouraged to provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place; and
 - (e) the SFC will monitor the Principles' reception and development to determine whether any amendments or the introduction of obligations or requirements may be necessary at a future stage.
4. As the Principles are largely supported by respondents, the SFC has decided to issue the Principles. A marked-up version of the Principles (showing changes made to the version in the Consultation Paper) which incorporates various amendments in response to comments received is set out in **Appendix A**. The main comments and concerns raised by respondents and the SFC's responses, are discussed in greater detail in this paper.
5. A list of the respondents (other than those who requested for anonymity) who sent in submissions is set out in **Appendix B**. The full text of the submissions can be viewed on the SFC website at www.sfc.hk. Submissions of six out of the 56 respondents requested for their submissions to be published on a "no-name" basis, five of which requested for anonymity altogether. Seven submissions (including second or supplemental submissions made by respondents) were received after the consultation period without having requested or been granted time extension for

their submissions but were nonetheless considered, given their consensus view on a couple of points.

6. The SFC would like to thank all respondents for their time and efforts in reviewing the proposals and providing the SFC with their detailed and thoughtful comments.

Part 1: Recap and further information on the Principles of Responsible Ownership

7. On 2 March 2015, the SFC issued the Consultation Paper for public consultation which ended on 2 June 2015. The Consultation Paper invited comments on the introduction of the Principles with the aim to provide guidance on how investors should fulfil their ownership responsibilities in relation to investments in Hong Kong listed companies.

Background and objective

8. The existing legal framework of Hong Kong promotes corporate governance for the protection of shareholders' interests in the following three areas:
 - (a) directors are required by law to act in the interests of the shareholders of a company and their obligations are contained in statute, common law as well as non-statutory provisions such as the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Hong Kong Listing Rules**);
 - (b) similarly there are provisions set out in statute, common law and non-statutory provisions (such as the Corporate Governance Code under the Hong Kong Listing Rules) which set out what a listed company can or cannot do; and
 - (c) shareholders have rights which can be used to protect themselves, including the right to vote, the right to communicate any questions or concerns to the company and the right to receive information from the company to monitor the progress of their investments.
9. Recent reforms to obligations, liabilities and responsibilities of directors and listed companies have been widely promoted and their importance are well recognised by the Hong Kong market. Conversely, the rights of shareholders have not been promoted to the same level. The SFC believes that strong corporate governance requires listed companies and their directors to be proactive, as well as shareholders to be both reactive and proactive. Without shareholders' involvement, the efforts of listed companies and their directors cannot be measured or appreciated.
10. Investors who take the initiative to review their investee companies' disclosures and monitor their investee companies (including the companies' performance, decisions and corporate actions) tend to have a better understanding of their investments. Well-informed investors are able to react effectively to their investee companies' disclosures and, in exercising their rights, are thereby able to engage effectively with investee companies. Effective engagement by investors generally leads to better-run companies.
11. Through promoting responsible ownership, Hong Kong can establish an investment culture where conscious engagement with investee companies is seen as paramount and fundamental. The Principles aim to further strengthen the corporate governance culture in Hong Kong, which is important for the overall health of the Hong Kong financial market. Greater effects can be achieved if direct or indirect investors of Hong Kong listed companies, including those who invest their funds directly as shareholders or through others as shareholders, actively apply the Principles. Each investor can contribute to improving corporate governance in listed companies through responsible ownership. The Principles aim to describe what the SFC perceives as best practice for investors who invest in Hong Kong listed companies in respect of share ownership.

12. Where investors cannot adopt the Principles in their entirety, disclosures made to their stakeholders to explain the reasons for doing so will nevertheless achieve greater transparency and understanding between investors and their stakeholders, hence fulfilling the spirit of the Principles.

Introduction of the Principles and effect

13. A majority of respondents (35 respondents¹) supported the Principles and recognised the benefits which the Principles can bring to the Hong Kong market. Many respondents in practice already observe similar codes or principles in other jurisdictions or currently participate in active investment management and welcome the introduction of the Principles in Hong Kong.
14. Those who were supportive of the Principles included amongst others 11 asset management firms, six individuals and 10 networks or associations.
15. Part 2 of this paper addresses the scope of “investors” which the Principles should capture. A summary of the general comments received from those against the Principles and the SFC’s responses are set out in Part 3 of this paper. Part 4 of this paper deals with respondents’ requests for clarification and Part 5 of this paper deals with the responses received pursuant to the questions asked in the Consultation Paper and the SFC’s responses.
16. The SFC has carefully considered the comments received. For the reasons set out in the Consultation Paper and having regard to the landscape of Hong Kong’s corporate governance measures as well as the majority support for the introduction of the Principles, the SFC considers that the Principles and their accompanying notes should be published but with certain modifications in response to comments received. A marked-up version of the Principles (showing changes made to the version in the Consultation Paper) which incorporates various amendments in response to comments received is set out in **Appendix A**.
17. The Principles are voluntary and open for investors to adopt. Investors who do not think that the Principles are relevant or suitable for them are encouraged to provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place. The spirit of the Principles would have already been achieved by promoting greater transparency and understanding between investors and their stakeholders.
18. Recognising that the Principles are not tailored to any specific investor groups, at this introductory stage of the Principles:
- (a) The SFC aims not to be prescriptive as to how each investor should adopt the Principles.
 - (b) Investors are encouraged to adopt the Principles in a way that best fits their institution, business model or business mandate.
 - (c) In adopting the Principles, investors should do so in a way that they think would best suit them and their stakeholders. However, the SFC encourages investors to adopt standards that go beyond the minimum required by laws and regulation and strive to discharge their ownership responsibilities to the highest standards.

¹ Out of 56 respondents, 35 were supportive of the introduction of the Principles, while 15 opposed the introduction of the Principles and six did not offer their views on this point.

19. As the Principles are voluntary in nature, their adoption and application will not be monitored at this stage. In the light of differing views on whether particular categories of investors should be required to adopt the Principles, the SFC is minded at this stage not to require any categories of investors or categories of SFC licensees to adopt the Principles. The SFC will monitor the Principles' reception and development to determine whether any amendments or the introduction of obligations or requirements may be necessary at a future stage.

Main amendments made to the Principles

Taking out references to "comply"

20. References to "comply" have been either taken out or replaced by "apply". The term "comply" may suggest that there are regulatory consequences if the Principles were not adopted or were not complied with, which is not the case. These amendments were made to ensure that there will be no misunderstanding on this point.

Elaboration on how to apply the Principles

21. The introduction section to the Principles has been amended to elaborate on how the Principles should be applied. In particular, it now stresses that investors should avoid stating that they have adopted the Principles but then disclose why each and every Principle does not apply to them. Instead, these investors should explain to their stakeholders why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place.

Taking out references to individual and retail investors

22. As explained in Part 2 of this paper, "investors" under the Principles are intended to include investors who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders.
23. Accordingly, the scope of "investors" should not include those who are accountable only to themselves for their investments (or are accountable only to family members pursuant to a personal relationship, with no intention to create a client or business relationship), such as individual and retail investors. References to individual and retail investors have therefore been removed from the Principles.

Elaboration on "stakeholders"

24. As further elaborated under "Stakeholders" in Part 4 of this paper, paragraph 11 under Principle 1 has been newly included to reflect what "stakeholders" under the Principles are intended to include. Accordingly, specific references to "investment-linked assurance schemes" have been amended to better reflect the intention and to capture a broader category of similar products.

Inside information

25. The original draft paragraph 20 under Principle 2 has been amended to remind investors that the Principles do not give investors the right to information beyond that available in compliance with legislation or regulation. This amendment was made to address the concerns received from respondents in relation to inside information. Please also refer to "Inside Information" in Part 4 of this paper for a further discussion on this point.

Acting collectively

26. The original draft paragraph 30 under Principle 5 asked investors to indicate their readiness to work with other investors and to indicate circumstances in which they would consider participating in collective engagement. While these indications would greatly facilitate shareholders to act collectively for the purposes of Principle 5, there may be implications under the Code on Takeovers and Mergers (**Takeovers Code**). The original draft paragraph 30 under Principle 5 has therefore been deleted to avoid any confusion. Please refer to “Acting collectively” in Part 4 of this paper for a further discussion and clarification on this point.

Examples of application

27. Set out below are examples of how investors might choose to adopt the Principles. These examples are not conclusive or exhaustive. In adopting the Principles, investors should do so in a way that they think would best suit them and their stakeholders. However, the SFC encourages investors to adopt standards that go beyond the minimum required by laws and regulation and strive to discharge their ownership responsibilities to the highest standards.

Diversified institutions or funds; funds with differing goals or purposes

28. Large institutions may have many divisions operating in different roles and providing various services. The SFC understands that the Principles may not be applicable to every operating arm within an institution given the nature of the services provided or performed by each arm, but that should not deter an institution from adopting the Principles. An institution could generally commit to the Principles and in their policy clearly state why or how the Principles would not be relevant to certain parts of the institution.
29. Likewise, an institution may operate numerous funds, to some of which the Principles may not be of relevance. This, too, should not deter an institution from adopting the Principles. An institution could generally commit to the Principles for the funds which they operate and in their policy clearly carve out specific funds which the Principles would not apply to and clearly explain the reasons for doing so. Providing such disclosure to stakeholders would enhance the degree of transparency and understanding between institutions and their stakeholders.
30. If stakeholders themselves feel strongly about the Principles, they have an option to select other types of investments managed by asset managers which adopt the Principles.

Private wealth managers

31. Private wealth managers can adopt the Principles and actively discharge ownership responsibilities in the straightforward scenario where they have ownership in investee companies. Similarly, where private wealth managers have the discretion to exercise ownership rights on behalf of their clients, they are encouraged to do so in accordance with the Principles.
32. The SFC recognises that private wealth managers generally do not have ownership in their clients’ investee companies or the powers and rights to perform the actions associated with the Principles. Where this is the case, private wealth managers could support the Principles by explaining to their clients that the responsibility of engagement remains with their clients and could advise their clients on the procedures for obtaining regular communications from investee companies and for voting shares. If appropriate, private wealth managers could implement policies and

channels whereby they could assist or guide their clients on how ownership responsibilities can be discharged.

33. Where it is not appropriate to adopt the Principles, private wealth managers are encouraged to explain to their clients why the Principles do not apply. As mentioned above, the SFC believes that providing disclosure to their clients as to why it is not appropriate for an advisor to adopt the Principles will nevertheless enhance the degree of transparency which would benefit their clients. If their clients feel strongly about the Principles, they have an option to select other types of investments or appoint other advisors who adopt the Principles or take on certain ownership responsibilities themselves, such as monitoring investee companies.

Agents; bare trustees and nominees

34. Similar to private wealth managers, agents typically do not have ownership in their clients' investee companies. Agents can nevertheless support the Principles by encouraging their clients to adopt the Principles. Agents could implement policies and channels whereby they assist or guide their clients on how ownership responsibilities can be discharged.
35. The SFC believes that genuine shareholder responsibility and engagement cannot be delegated. While shareholder engagement can be performed by an agent on behalf of investors, investors should nonetheless monitor their agents to ensure that they are performing the actions according to the investors' wishes.
36. Bare trustees and nominees (such as CCASS²) are not expected to fall within the scope of the Principles and hence the Principles would not apply or be relevant to them.

Hong Kong based investors with foreign investments or foreign investors with investments in Hong Kong listed shares

37. The Principles are in general aimed at direct or indirect investors of Hong Kong listed companies. However, the SFC would like to encourage investors based in Hong Kong to observe similar codes or principles of other jurisdictions relating to their foreign investment or apply the Principles to their foreign investment. For funds that comprise both Hong Kong listed companies and foreign companies, if fund managers apply the Principles to their Hong Kong investments then it should be natural or easy to apply the Principles to all of their investments.
38. Similarly, foreign investors are encouraged to observe the Principles for their investments in Hong Kong listed companies as the Principles' success lies in all investors playing their part.

Next stages

39. The SFC considers that after the introduction of the Principles it should review the following:
- (a) should there be requirements for specified institutions to disclose whether they have adopted the Principles and, if not, explain why;
 - (b) should the disclosure of a fund manager's engagement policy be mandated, whether by adoption of the Principles or an equivalent overseas stewardship code and, if so, how it should be disclosed; and

² Also known as the Central Clearing and Settlement System

- (c) if intermediaries hold investments on behalf of individual investors, should intermediaries explain, if appropriate, in writing whether ownership responsibilities rest with the intermediaries or individuals and, if the latter, whether the individuals should be advised on how they can exercise their ownership responsibilities.

Part 2: Scope of “investors” captured by the Principles

Summary

40. The Principles are open for investors to adopt on a voluntary basis. The SFC envisages “investors” to include those who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders. Accordingly, the Principles should not include investors who are accountable only to themselves for their investments (or are accountable only to family members pursuant to a personal relationship, with no intention to create a client or business relationship), such as individual and retail investors.

Public comments – whether relevant to all investors or only to institutional investors

41. The question of whether the Principles should be relevant to all investors or only to institutional investors was asked in the Consultation Paper. The majority of respondents (29 respondents) did not respond to this question. Out of those who responded to this question, 11 respondents thought that the Principles should apply to all investors while 16 respondents thought that the Principles should only apply to institutional investors.
42. There was no consensus as to which types of investors should be captured within, or excluded from, the scope of the Principles but suggestions included the inclusion of asset owners, asset managers and regulated institutional investors. One respondent suggested that private banks which act as agents or nominees for their clients and thereby do not have ownership over assets should be excluded.
43. Respondents who thought that the Principles should apply to all investors (including individual and retail investors) also noted that individual and retail investors may in practice have difficulties in applying the Principles and that the Principles would have the greatest practical relevance to institutional investors. Similarly, respondents who did not think that the Principles should apply to individual and retail investors questioned how the Principles could in practice be applied by individual and retail investors.
44. Three respondents suggested that a retail shareholders’ group should be developed to provide greater participation in and awareness of stewardship issues. Two respondents suggested that the Principles should focus on institutional investors first and for institutional investors to set an example or precedent, with retail investors to follow suit at a later stage.

Public comments – whether individual or retail investors would find the Principles useful

45. The Consultation Paper also asked whether individual or retail investors would find the Principles useful. Only six respondents gave views on this question and the responses were split evenly between “yes” and “no”. Those who did not think that the Principles would be useful for individual or retail investors nonetheless thought that the Principles would serve as a useful guidance, such as when picking an asset manager.
46. Four respondents suggested that there should be a retail shareholders’ group or a platform developed to provide greater participation in and awareness of responsible ownership issues.
47. Other responses gave suggestions which included giving investor education to individual or retail investors in terms of responsible investing and their rights as a shareholder, that the SFC should require all regulated intermediaries in Hong Kong to seek voting instructions from clients for each shareholder meeting and that the

SFC should develop a guide in relation to engagement between listed companies and their investors. One respondent pointed out that there is currently no regulatory obligation on retail brokerages to solicit votes or provide information in a timely fashion.

SFC's response

48. In light of the divergent views on the scope or categories of investors to which the Principles should apply and given that the SFC believes they should not seek to require any class of investors to adopt the Principles at this stage, it will be left to an investor to decide whether to adopt the Principles.
49. The SFC envisages "investors" to include those who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders. This includes those who hold shares directly and those who entrust funds or entrust shareholder functions to others who hold shares. Investors who entrust shareholder functions to others or entrust funds to others who buy shares are encouraged to apply the Principles, albeit indirectly, by considering whether the person holding the shareholder rights applies the Principles in a way that is in the investor's best interest.
50. Having taken into account the responses received, the SFC has decided to take the view that the scope of "investors" under the Principles should not include those who are accountable only to themselves for their investments (or are accountable only to family members pursuant to a personal relationship, with no intention to create a client or business relationship), such as individual and retail investors. The SFC agrees that it would be inappropriate to ask individual and retail investors to form policies or make disclosures.
51. Notwithstanding the above, the Principles will not define the scope or meaning of "investors", as the SFC intends to leave it to investors to determine whether the Principles are applicable to them. Even if investors determine that the Principles are applicable to them but nonetheless choose not to adopt the Principles, such as on the basis that the Principles are not relevant to or suitable for them, this would not result in any regulatory consequences. While the SFC encourages all investors to adopt the Principles, where investors have not adopted the Principles they are encouraged to at least provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place.
52. Since investors captured by the Principles would mainly comprise institutional investors, the original draft paragraph 18 under Principle 2 and paragraph 23 under Principle 3 will remain unchanged as suggested engagement mechanisms or actions. Many respondents who were supportive of the Principles stated that they already participate in various levels of shareholder engagement. The original draft paragraphs 18 and 23 do not mandate investors to adopt certain engagement mechanisms or take certain actions. These are purely suggestions and are not an indication of preferred engagement mechanisms or actions. Not using the mechanisms or taking the actions suggested under the original draft paragraphs 18 and 23 does not equate to non-adoption of the Principles. Shareholder engagement should only be performed when or where appropriate; investors should not use these suggested mechanisms or take actions only to appear to adopt the Principles. However, it should be stressed that the existence of these suggested engagement mechanisms or actions are not newly created by the Principles, but are what institutional investors should already be generally aware of.

53. The SFC agrees that a retail shareholders' group may aid the initiative to promote responsible ownership and will take into account this suggestion in future efforts to promote the spirit of the Principles among individual and retail investors.

Individual and retail investors not intended to fall within the scope of "investors"

54. As mentioned above, the scope of "investors" under the Principles should not include those who are accountable only to themselves for their investments (or are accountable only to family members pursuant to a personal relationship, with no intention to create a client or business relationship), such as individual and retail investors.
55. Nevertheless, the SFC encourages individual and retail investors to use the Principles as a point of reference, as the Principles can provide valuable guidance on share ownership engagement. The most straightforward way in which individual and retail investors can use the Principles is when choosing an asset manager who has adopted the Principles.
56. Although individual and retail investors are in a different position (in terms of accountability) from other investors like institutional investors, they still play an important role in terms of corporate governance in listed companies. They should recognise the ownership rights that are available to them, including the right to exercise their votes at annual general meetings. However, the SFC thinks that it would be more appropriate to promote individual and retail investors' rights through investor education, rather than in the Principles.

Part 3: General concerns received and the SFC's responses

57. A minority of respondents (15 respondents³) opposed the introduction of the Principles and generally raised the concerns summarised in this Part. These respondents included two law firms, nine Hong Kong listed companies and four networks or associations.

Creation of more burden

Public comments

58. Some respondents expressed concerns that the Principles will create more cost or burden, which outweigh the benefits. Examples of cost or burden include:
- (a) investors requiring personnel with appropriate skill level and experience to hold constructive dialogue with listed companies;
 - (b) pressures to comply with and to satisfy requests made by investors will bring about costs (in terms of expenditure of resources or administrative costs); and
 - (c) engagement could inhibit flexibility of investment process and exert negative impact on listed companies.

SFC's response

59. The SFC believes that the cost argument against the introduction of the Principles has not been substantiated. Many respondents who were supportive of the Principles indicated that they already have systems in place to facilitate shareholder engagement. Additionally, the SFC expects listed companies to have channels for shareholder engagement already in place. The Principles aim to encourage shareholders to utilise these channels and do not create any new channels or concepts. Please also refer to the section "Costs and benefits" in Part 5 of this paper for a further discussion on this point.
60. The SFC recognises that active engagement would involve some costs. It is reasonable to assume that there will be initial implementation and ongoing costs for those investors who do not currently have a policy of engagement but choose to change their institution's policy to one that involves more active ownership responsibilities. Investors may consider these costs to be inappropriate for their business model. The voluntary approach of the Principles does not compel investors to have an active engagement policy; they can simply not adopt the Principles (but are encouraged to provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted and, if applicable, explain what alternative measures they have in place). The Principles do not compel investors to embrace engagement with listed companies.
61. Accordingly, fund managers may elect not to adopt the Principles because of the costs involved. Alternatively, fund managers may adopt a policy of limited engagement to reduce costs and clearly explain their reasons.
62. The SFC believes that good corporate governance requires a two-way dialogue between the company and/or their directors and their shareholders. Shareholders play a key role in corporate governance by monitoring and, when necessary, responding to a company's corporate governance efforts (or lack thereof). Although

³ Out of 56 respondents, 35 were supportive of the introduction of the Principles, while 15 opposed the introduction of the Principles and six did not offer their views on this point.

the benefits derived from the Principles cannot easily be quantified, the SFC believes that the benefits resulting from shareholder engagement will outweigh any costs but this is ultimately a decision for investors and fund managers.

Well-established and working channels already exist

Public comments

63. Some respondents pointed out that Hong Kong's regulatory and business environment already has well-established channels for investors to engage with directors and senior management and to exercise their rights as shareholders, hence there is no additional benefit with the Principles. They also added that there is no shortage of information in the market for investors to make investment decisions.

SFC's response

64. The SFC agrees that there are many existing channels available for investors to engage with listed companies. Through law, rules and regulation, the SFC strives to ensure that there is adequate, equal and prompt dissemination of information to shareholders.
65. However, the Principles do not seek to introduce new channels of engagement or concepts, nor do the Principles encourage investors to expect listed companies to develop new channels for engagement. The Principles aim to encourage investors to utilise the well-established channels of engagement to help improve a listed company's corporate governance.
66. Investors may have access to information and engagement channels, but if the channels are not fully utilised or if investors do not read or process the information received and react accordingly, then the corporate governance efforts of listed companies and their directors cannot be fully appreciated. While regulators attempt to curb poor corporate governance behaviour of listed companies, the SFC believes that shareholders can also play a large part by asking companies to improve their corporate governance through active engagement.

Only further investor education is required; recent revisions in rules, regulation and laws targeting corporate governance are adequate and the goals to be achieved by the Principles are unclear

Public comments

67. Various respondents have suggested that further investor education should be introduced instead of the need for the Principles, on the basis that:
- (a) revision in rules, regulation and laws have been recently introduced to increase transparency and improve corporate governance, for example the revisions made to the Corporate Governance Code under the Hong Kong Listing Rules and statutory backing for disclosure of inside information and directors' fiduciary duties; and
 - (b) the goals to be achieved by the Principles are unclear. If no specific problem exists, then market intervention does not seem necessary.

SFC's response

68. The recent revisions mainly relate to companies and directors' actions in respect of corporate governance, but the SFC believes that good corporate governance should also involve shareholders.

69. Following the global financial crisis of 2008, the importance of roles and responsibilities of institutional investors in corporate governance has been placed under scrutiny by a number of financial regulators worldwide. The SFC believes that shareholders' participation in Hong Kong can be improved, which the Principles aim to address.
70. Investor education is important and will complement the Principles and the SFC envisages that investor education will provide added guidance to investors on the use of the Principles to better improve shareholder engagement.

Confusing roles or responsibilities of others and short-termism

Public comments

71. A few respondents pointed out that the Principles will confuse the roles, responsibilities or interfere with the job of others, such as independent non-executive directors, auditors and regulators. It may even create strategic conflict or lead to short termism of decisions of directors, driven by short term goals of some investors.

SFC's response

72. The Principles aim to promote the monitoring of listed companies and the use of engagement channels by investors, which are not new concepts. The roles of independent non-executive directors, auditors, shareholders and regulators have long been established. The SFC has not identified any responses that expressed any existing conflicts or confusion of roles or responsibilities as a result of the current practice, thus the SFC does not foresee any new issues that would arise from the implementation of the Principles.
73. Monitoring by shareholders to some degree should already be expected by listed companies. Disclosures made by listed companies are predominately for investors' information. Increased monitoring by investors would not necessarily lead to more invasive shareholder engagement if investors are kept well-informed by listed companies.
74. The SFC recognises that investors may have differing views or goals in relation to their investments, including short term goals. Engagement should be a constructive dialogue between shareholders and a listed company or its directors, rather than a means for shareholders to run a company. The Principles in no way seek to involve shareholders in management nor do they advocate a particular time horizon (short-term or long-term) or take view on any preference. The Principles encourage investors to assess how well directors perform their roles and exercise their legal rights, one of which is to vote on appointment of directors of the companies in which they invest.
75. Greater engagement and attention by shareholders will provide the opportunity for directors to explain a listed company's long-term goals and actions to its shareholders. The market is more likely to fully value a company when it understands the strategic direction and thinking of directors. Despite differing views or goals, these types of dialogue can promote better understanding between the investors and their investee companies.

Inadvertent leakage of inside information

Public comments

76. Some respondents expressed concerns that listed companies engaging with shareholders may result in accidental dissemination of inside information, especially when pressed by aggressive fund managers or analysts.

SFC's response

77. Please refer to the section "Inside Information" in Part 4 of this paper for more information on inside information and maintaining its confidentiality.
78. Many respondents who were supportive of the Principles stated that they already participate in various levels of shareholder engagement. Engagement is an existing concept that currently takes place in the market, which the Principles aim to promote.
79. There were no submissions which indicated that past engagements have resulted in leakage of inside information. It is possible for listed companies to engage with their investors without divulging inside information. For example, it is possible to discuss broader issues of strategy, management quality and corporate governance without sharing material non-public price-sensitive information.

Shareholders are under no legal duty or obligation to engage

Public comments

80. A few respondents have noted that shareholders are under no legal duty or obligation to engage with listed companies and that they have a right to be passive investors.

SFC's response

81. In publishing the Principles, the SFC is not seeking to establish a duty although it encourages investors to adopt the Principles. Investors, whether of their own funds or funds entrusted to them, may choose not to engage. That is for them to determine.
82. The SFC believes that it will be beneficial for all shareholders to engage with their investee companies to ensure that their directors are acting in the best interests of shareholders and stakeholders. The SFC encourages investors to consider whether to adopt the Principles. Those who determine not to do so are encouraged to make that clear to their stakeholders by providing disclosures which clearly explain why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place.

Quasi-mandatory, box-ticking exercise

Public comments

83. Some respondents stated that the Principles may turn out to be quasi-mandatory in that investors may feel pressured to comply with the Principles which will eventually turn into a box-ticking exercise, rather than garner any meaningful compliance and disclosure.

SFC's response

84. The SFC agrees that there is a danger that investors will assert they have adopted the Principles when they have not done so. For this reason, the SFC stresses that adoption is voluntary. The SFC strongly discourages investors to assert adoption of the Principles when in fact they have not done so. To maximise flexibility for investors, the SFC does not wish to be prescriptive in terms of how investors should apply the Principles or the disclosures that entail. The SFC expects investors to adopt the Principles and make disclosures in a way that each investor thinks would best suit them and their stakeholders.
85. Scenarios where investors think that the Principles are not relevant to or suitable for them and will therefore not adopt the Principles may include:
- (a) adoption of the Principles would not be in line with their business model or mandate;
 - (b) it may not be cost effective to apply the Principles given their business model;
 - (c) it may not be practicable to apply the Principles given their business model or mandate;
 - (d) it is not in their mandate to engage; and
 - (e) the scenario where application has been outsourced to third parties due to conflict of interests.

In these circumstances, the SFC encourages investors to provide disclosure to their stakeholders which clearly explains why the Principles have not been adopted and, if applicable, explain what alternative measures they have in place.

86. Even when the Principles have been adopted, a clear disclosure on why investors have deviated from a specific Principle or aspects of a Principle will benefit stakeholders having achieved greater transparency. For example, stakeholders can take up the monitoring process themselves if they feel strongly about monitoring listed companies after realising that the people to whom they have entrusted their funds do not do so.

Suggestions of other principles

Public comments

87. Some respondents, although mostly agreeing with the Principles, suggested additional or alternative principles, such as in relation to:
- (a) independent directors being elected by independent shareholders;
 - (b) investors' right to information to certain financial statements and full disclosure of counterparties in notifiable transactions, option grants and placement of shares or convertible securities;
 - (c) protection from dilution of investors' ownership rights;
 - (d) requiring all regulated intermediaries to seek voting instructions; and
 - (e) introduction of class action rights and the legalisation of champerty and maintenance and contingent legal fees.

SFC's response

88. The SFC welcomes these suggestions that deal with wider corporate governance issues. As the consultation on the Principles is aimed at encouraging investors to play their part in enhancing corporate governance, the SFC will consider each of these ideas in the future and when appropriate.

Should not only follow other jurisdictions

Public comments

89. A few respondents commented that since Hong Kong is a different culture from other jurisdictions, the Principles should not be introduced purely because other jurisdictions have introduced or are introducing similar codes or principles.

SFC's response

90. There is currently little initiative in the Hong Kong market to promote investor engagement and the SFC believes that the Principles will address this void. Active monitoring and engagement by investors will lead to improved corporate governance and will benefit the Hong Kong market as a whole.
91. Other jurisdictions' codes and principles have provided a useful starting point of reference. However, in preparing the Principles the SFC has adopted an approach that reflects the nature and culture of the Hong Kong market. This is seen in the approach of providing Principles of responsible ownership rather than Stewardship Codes.

Part 4: Clarification on aspects of the Principles

Adopting the Principles

92. If investors choose to adopt the Principles, they do so by first disclosing to their stakeholders that they have done so, and then proceed to apply the Principles in their entirety or explain any deviations. At this stage, the SFC does not intend to keep or publish a list of investors who have chosen to adopt the Principles.
93. If investors do not think that the Principles are relevant to or suitable for them, they are encouraged to provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place. The spirit of the Principles would have already been achieved by promoting greater transparency and understanding between investors and their stakeholders.
94. Where investors have chosen to adopt the Principles, they should use their best efforts to apply each Principle. Where it is not appropriate to apply a specific Principle or aspects of a Principle, investors should clearly disclose to their stakeholders the reasons for such deviations.
95. Investors should avoid stating that they have adopted the Principles but then disclose why each and every Principle does not apply to them. Similarly, where an investor decides not to have a policy on shareholder engagement, they cannot be said to have adopted the Principles. Instead, these investors should explain to their stakeholders why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place.
96. The above approach to the Principles is slightly different from that in the United Kingdom. Like the Principles, the UK Stewardship Code is voluntary in that investors can choose whether or not to sign up to the UK Stewardship Code. However, they have not differentiated between “signing up” and “comply-or-explain” and as a result, there are cases where investors have signed up to the UK Stewardship Code and present themselves as having complied with it but in fact have explained why they cannot apply each code.
97. It should be noted that the Financial Services Authority in the United Kingdom has introduced a requirement⁴ in December 2010 for all Financial Services Authority authorised firms (other than venture capital firms) to disclose a statement on their own website (or in another accessible form) of the nature of their commitment to the UK Stewardship Code or their alternative investment strategy. Compliance with the UK Stewardship Code is not in itself compulsory in the United Kingdom. Hong Kong has decided not to impose any requirements at this stage, but will continue to monitor the situation to decide at a future stage whether there is the need to implement a similar requirement for certain groups of entities, such as SFC-regulated entities.

Applying the Principles

98. The Principles are not mandatory rules. The SFC does not envisage a “one size fits all” approach. Deviations from the Principles are acceptable.
99. To avoid “box-ticking”, investors must consider their own circumstances, the nature of their operations and the nature of their stakeholders. Where an investor considers a more suitable alternative to a Principle exists, it should adopt the alternative and give reasons. However, that investor should explain to its

⁴ Financial Conduct Authority Conduct of Business Rule 2.2.3: <http://fshandbook.info/FS/html/handbook/COBS/2/2>

stakeholders why the Principles can be better achieved by other means rather than strict adoption of the Principles.

100. Stakeholders should not necessarily consider departures from the Principles as non-adoption of the Principles. They should carefully consider and evaluate explanations given by investors, taking into account the purpose of the Principles and effective engagements.

Investors

101. The Principles are intended to apply to investors who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders (see discussion in Part 2 of this paper).
102. While the SFC has not defined “investors” to allow flexibility in the application of the Principles, to provide further guidance the SFC envisages “investors” to include the following scenarios, unless they are investors who are accountable only to themselves for their investments (or are accountable only to family members pursuant to a personal relationship, with no intention to create a client or business relationship), such as individual and retail investors.
- (a) scenario 1: those who are shareholders themselves;
 - (b) scenario 2: shareholders who entrust their shareholder functions to others;
 - (c) scenario 3: the “others” described in scenario 2 above, who exercise shareholder functions on behalf of others;
 - (d) scenario 4: those who entrust their investment to others who hold shares in Hong Kong listed companies as part of the investments;
 - (e) scenario 5: the “others” described in scenario 4 above, who hold shares in Hong Kong listed companies on behalf of others as part of investments;
 - (f) scenario 6: those who entrust their investment to others who invest money on behalf of their clients but do not directly invest in shares of Hong Kong listed companies themselves; and
 - (g) scenario 7: the “others” described in scenario 6 above, who invest money on behalf of their clients but do not directly invest in shares of Hong Kong listed companies themselves.
103. Investors who entrust their investment or shareholder functions to others can apply the Principles by encouraging those “others” in the above scenarios to also apply the Principles.

Disclosure

104. Any disclosures made by investors pursuant to the Principles should be aimed at their stakeholders, and possibly potential stakeholders. The SFC expects investors to adopt the Principles and make disclosures in a way that each investor thinks would best suit them and their stakeholders. Factors which investors should bear in mind when making disclosures include the methods, standards, content and language that would best suit their clients or stakeholders.
105. The SFC encourages investors to adopt standards that go beyond the minimum required by laws and regulation and to strive to provide disclosures of the highest standards. Any “box-ticking” disclosures should be avoided.

Stakeholders

106. Stakeholders should be informed of investors' policies in shareholder engagement and participate in responsible ownership and they should recognise that participating in the Principles will indirectly benefit stakeholders.
107. The SFC has not defined "stakeholders" to allow flexibility in the application of the Principles, especially since "stakeholders" have different meanings to each investor. To provide further guidance the SFC envisages "stakeholders" to include:
- (a) scenario 1: shareholders who entrust their shareholder functions to investors;
 - (b) scenario 2: those who entrust their investment to investors who hold shares in Hong Kong listed companies as part of the investments;
 - (c) scenario 3: those who entrust their investment to investors who invest money on behalf of their clients but do not directly invest in shares of Hong Kong listed companies themselves; and
 - (d) scenario 4: the investors as described in scenario 3 above who invest money on behalf of their clients but do not directly invest in shares of Hong Kong listed companies themselves – these investors would also be stakeholders of those to whom they ultimately entrust to invest directly in shares of Hong Kong listed companies.
108. The return or value of certain retail investment products, such as investment-linked assurance schemes issued by insurance companies and equity-linked structured products issued by banks, may be linked (directly or indirectly) or calculated with reference to the performance of listed shares in Hong Kong. Whilst investors in these products do not have any rights over or ownership of such shares or funds investing in such shares, the engagement policies of product issuers may be relevant to them. Accordingly, issuers of retail investment products should consider whether investors in such products should be regarded as stakeholders for the purpose of applying the Principles.

Engaging with investee companies

109. It should be stressed that investors should not engage with investee companies for the purposes of window-dressing or only to appear that they have been actively engaging with investee companies, which would place undue burden and cost on investee companies in meeting investors' requests. Investors should bear in mind that the management of a listed company should be left with senior management and directors. Shareholders should only step in on management matters in limited situations such as when senior management and directors have acted ultra vires or have breached their fiduciary duties.
110. Whether engagement with investee companies is "meaningful" or "meaningless" is subjective to investors and will be left to their discretion, but investors should bear in mind that the Principles strive to achieve meaningful engagement for better corporate governance.

Acting collectively

111. Some respondents have requested for clarity in respect of any implications under the "acting in concert" provisions of the Takeovers Code. There may be implications under the "acting in concert" provisions of the Takeovers Code if shareholders act collectively. The question of whether a concert party group has been formed depends on the particular facts and circumstances of each case. The Takeovers

Code provides that shareholders collectively voting together on a particular resolution would not normally lead to an offer obligation although that circumstance may be taken into account as an indication that the shareholders are acting in concert. Where appropriate, the Takeovers Executive⁵ should be consulted at the earliest opportunity.

Inside information

112. Listed companies are under a statutory duty to disclose all inside information. Under Part XIVA of the Securities and Futures Ordinance (Cap. 571) (**SFO**), a corporation must disclose any inside information to the public “as soon as reasonably practicable” unless the information falls within any of the safe harbours as provided in the SFO, in which case there is a strict statutory obligation to maintain confidentiality of the inside information. In these rare circumstances a listed company needs to be alert to the absolute necessity to maintain confidentiality. If a listed company has a heightened awareness of the legal necessity for confidentiality, inadvertent leaks of inside information should be highly unlikely.
113. The Principles encourage investors to engage with investee companies and note that engagement may include meetings with a company’s management. However, when seeking to engage directly with management of an investee company, investors should be aware that the Principles do not give investors the right to information beyond that available in compliance with legislation or regulation. In answering requests for meetings or information investee companies have a duty to ensure that confidential inside information is not leaked and to ensure that investors are treated equally.

⁵ Tel: (852) 2231 1210, Fax: (852) 2810 5385, email: cmailbox@sfc.hk

Part 5: Comments received to SFC's specific questions and the SFC's responses

Relevant to all investors or only to institutional investors

114. Please refer to Part 2 of this paper.

Suggestions from listed companies on how to encourage the appropriate level of engagement

Public comments

115. Respondents made suggestions on how to encourage the appropriate level of shareholder engagement, four of which suggested that Hong Kong must be elevated from a management-mediated process to a dialogue with the participation of the board of directors, instead of a meeting with investor relations personnel.
116. Other suggestions included:
- (a) listed companies having a clear plan or policy which identifies a group of investors for the listed companies to proactively reach out to;
 - (b) the creation of a "shareholder liaison committee" within a listed company;
 - (c) establishing a mechanism for communication which ensures opinions from all shareholders could be received and addressed by listed companies;
 - (d) listed companies being prepared to engage throughout the year and not just at annual general meetings;
 - (e) increasing transparency and information available to Hong Kong listed companies on who their investors are, especially those holding their interest through systems such as CCASS – this would improve companies' visibility of investor voting patterns and facilitate engagement; and
 - (f) the SFC providing guidance on implementation of the Principles.

SFC's response

117. The SFC will take these suggestions into consideration, especially in any future efforts to promote the Principles. For shareholder engagement to be successful, it requires listed companies to be receptive to shareholders' efforts. The SFC encourages listed companies to take these suggestions into consideration and recognises the benefits of engaging with their shareholders, which will ultimately lead to stronger corporate governance and performance of listed companies.

Costs and benefits

Public comments

118. 21 respondents shared their views on the likely costs and benefits arising from institutional shareholders' compliance with the Principles, while 35 respondents did not answer this question.
119. Seven respondents thought that the benefits arising from the Principles would outweigh the costs involved in adopting the Principles. However, some respondents also stated that the incremental cost in adopting the Principles would be marginal

for those investors who already observe similar principles, codes or rules in other jurisdictions.

120. The costs pointed out by eight respondents were mainly in relation to the application of the Principles and in making the relevant disclosures. Such costs would include internal resources for reviewing and updating investment policy, training and implementation of the policy, monitoring compliance, putting in place electronic voting systems, resources for vote administration, additional resources dedicated to meeting with board of directors and management and the costs involving external advisors.
121. Two respondents thought that the costs could be significant for small fund management set-ups with an investment strategy of holding highly diversified portfolios. Another respondent also mentioned that the costs would depend on the portfolio size and operations of the institutional investors.
122. One respondent thought that the costs involved would be hugely disproportionate to any benefits to end-investors for funds that do not pursue an active strategy and/or do not hold a large proportion of Hong Kong-listed shares in their portfolio. By contrast, one respondent said that the costs involved are administrative in nature and, for the most part, one-off at implementation stage. Another respondent said that the implementation and organisational costs would be modest and should not have a significant impact on their overall operations or expenses.
123. The perceived benefits that will arise from the Principles differed among respondents. Responses included:
- (a) the benefits will be substantial as companies with active and involved owners are more likely to perform better and it adds and preserves value over time;
 - (b) the Principles will benefit major long-term institutional investors holding significant stakes in listed companies;
 - (c) public recognition of adoption of the Principles may bring reputational benefits;
 - (d) the Principles could raise Hong Kong's standing as a reputable financial centre due to improved corporate governance that is demanded; and
 - (e) higher quality management at investee companies could in turn lead to higher long-term investment returns with lower risk.
124. Only one respondent explicitly stated that the Principles would not bring about any benefits.

SFC's response

125. The SFC believes that the benefits derived from the Principles will outweigh any costs involved in the implementation and execution of the Principles. The aims of the Principles are to improve shareholder engagement and to increase transparency between investors and their stakeholders. An increased dialogue between shareholders and investee companies will lead to greater corporate governance and accountability by investee companies.
126. The SFC recognises that one of the highest costs involved in the adoption of the Principles would be implementation costs, such as the establishment of policies, implementation of those policies and initial disclosures. However, these implementation costs should generally be a one-off expense. There may also be

costs involved in the application of the Principles, such as monitoring investee companies' performances and monitoring whether certain policies or disclosures need to be revised or updated, but those costs are expected to be minimal.

127. Whilst the SFC believes the benefits will outweigh costs, the SFC recognises there are diverse views. Accordingly, the SFC is not proposing to require any class of investors to adopt the Principles. This should be left to the investors to decide whether to adopt the Principles. Asset managers should decide for themselves whether engagement is in the interest of their clients.

Other questions asked in the Consultation Paper and public comments received

128. The Consultation Paper posed a number of questions around the issue of what types of investors or groups of people should the Principles be applied to, whether some investors should be required to adopt the Principles and hurdles or difficulties in applying the Principles (collectively, **Other Questions**). Respondents' answers to the Other Questions are summarised below.
129. As the Principles will be introduced as voluntary for investors to adopt and are intended to apply only to investors who invest money, or hold shares, on behalf of clients and other stakeholders and are accountable to such clients and other stakeholders, at this stage the Other Questions are not relevant in this initial introduction of the Principles. In the light of differing views on whether particular categories of investors should be required to adopt the Principles, the SFC is minded at this stage not to require any category of investor or category of SFC licensee to adopt the Principles.
130. The SFC will monitor the Principles' reception and development to determine whether any amendments or the introduction of obligations or requirements may be necessary at a future stage, during which the responses given to the Other Questions will be taken into consideration.

Summary of responses to the Other Questions

Types of institutions within or outside the characterisation of "institutional investors"

131. 16 respondents provided their views on this question. There were no clear answers or consensus as to which type of institutions should fall within or outside of the broad characterisation of "institutional investors" and their agents.
132. Three respondents thought that "institutional investors" should follow the definition of "Professional Investors" under the SFO. Two respondents suggested that "institutional investors" should include all those authorised, licensed and/or regulated by the Hong Kong Monetary Authority, the Mandatory Provident Fund Schemes Authority, the Office of the Commissioner of Insurance and the SFC (**Four Regulators**) and another two respondents thought that asset owners and asset managers should be included. Other suggestions of those who should be included within the meaning of "institutional investors" included regulated professional investors, all those regulated under the SFO, all those registered with any regulators in Hong Kong and all licensed institutional investors.
133. There was a mix of suggestions in terms of who should be excluded from the meaning of "institutional investors"; these included smaller asset managers, asset owners with assets under management below a certain threshold, passive managers, trustees and custodians, agents or service providers, private banks which act as an agent or nominee for their clients and ultimate investor or beneficial shareholders.

Whether institutional investors should be encouraged or obliged to “comply-or-explain”

134. 25 respondents gave their views on the question of whether institutional investors be encouraged or obliged to apply the Principles on a “comply-or-explain” basis. Out of these respondents, a majority of 18 respondents stated that the Principles should be encouraged to apply on a “comply-or-explain” basis, while seven respondents stated that institutional investors should be obliged to apply the Principles on a “comply-or-explain” basis. A few respondents gave strong views that the Principles should not be made compulsory to any groups of investors, at least not at this stage.
135. The responses received as to which types of institutional investors should be encouraged or obliged to apply the Principles were mixed, as was the question as to what should they be asked to disclose and to whom. A summary of the more prevalent responses is set out below:
- (a) Three respondents thought that statutory asset owners and public institutions managing funds collected from the general public should be obliged to apply the Principles, including those authorised, licensed and/or regulated by the Four Regulators. Another three respondents thought that only those authorised, licensed and/or regulated by the Four Regulators should be obliged to observe the Principles. Other suggestions by respondents in terms of institutions that should be obliged to observe the Principles included institutional asset managers, entities that hold regulated status in Hong Kong, all Hong Kong-based institutional investors and all entities that hold voting rights.
 - (b) Seven respondents thought that engagement and voting policies and their actual engagement and voting activities should be disclosed. Three respondents said that any conflicts of interest and how they have been discharged should be disclosed.
 - (c) Seven respondents thought that disclosure should be on the websites of investor or in some form of online public disclosure. On the other hand, two respondents thought that disclosure should be aimed at clients rather than the general public.
136. Other comments and observations included introducing the Principles in phases starting with statutory and public bodies, making it compulsory for regulated investors only in a second phase and giving the Principles some legal backing if proved ineffective being voluntary.

Whether certain types of organisations should be required to disclose whether or not they comply with the Principles

137. 20 respondents shared their views on the question, nine of which thought that no organisation should be required to disclose whether or not they comply with the Principles, while 11 respondents thought that some types of organisations should be required to do so.
138. Of those who thought that certain types of organisations should be required to disclose whether or not they comply with the Principles, three respondents thought that statutory asset owners and public institutions managing funds collected from the general public (including the Hong Kong Monetary Authority, the Hong Kong Jockey Club, the Hospital Authority and Mandatory Provident Fund providers) should fall within those types of organisations. Four respondents thought that all those authorised, licensed and/or regulated by the Four Regulators should be required to disclose whether or not they comply with the Principles.

139. Some respondents expressed their objection to making the Principles a requirement for certain types of organisations to disclose whether or not they comply with the Principles, or at least not in the initial introduction phase of the Principles.

Whether individual or retail investors will find the Principles useful

140. Please refer to Part 2 of this paper.

Whether entities such as voting services agencies and investment consultants should be encouraged to commit to the spirit of the Principles

141. Nine respondents thought that entities such as voting services agencies and investment consultants should be encouraged to commit to the spirit of the Principles, whereas seven respondents disagreed. 40 respondents did not provide a response to this question.
142. A suggested way of facilitating such entities included having some form of formal training or accreditation from an external body on the scope, objectives and content of the Principles to be applied to those entities. One respondent suggested that a separate set of principles should be prepared for voting services agencies and investment consultants altogether.
143. One respondent who was against the encouragement of such entities to commit to the spirit of the Principles thought that there was no compelling justification to encompass those such as voting services agencies and investment consultants. Another respondent thought that their inclusion would not provide any effective utility and that the Principles should not apply to agents of shareholders. Others thought that the Principles should not apply to entities such as voting services agencies and investment consultants altogether because genuine stewardship cannot be delegated. Those respondents also thought that the Principles should not apply directly to entities such as voting services agencies and investment consultants since they are neither shareholders nor investors and hence the Principles are irrelevant to them.

Hurdles

144. 20 respondents shared their views on possible hurdles or other reasons that would prevent or discourage Hong Kong institutional investors from applying the Principles and two respondents did not think there would be any hurdles or other reasons to discourage Hong Kong institutional investors from applying the Principles. 34 respondents did not share their views on this question.
145. The main hurdles expressed by respondents were:
- (a) potential conflicts with existing regulatory or statutory requirements, namely “acting in concert” implications under the Takeovers Code and the inside information regime under the SFO;
 - (b) administrative costs and the cost of compliance with the Principles, including small firms applying the Principles, those holding a large portfolio of companies in different industries and those who find it difficult to justify any additional cost incurred which are passed to clients and to quantify the benefits; and
 - (c) practical difficulties in applying the Principles for investment managers with diversified portfolios or those which hold shares with short-term tactical view.

Whether investors based in Hong Kong should be encouraged to abide by codes or principles of other jurisdictions relating to their foreign investment

146. Eight respondents thought that investors based in Hong Kong should be encouraged to abide by the codes or principles of other jurisdictions in relation to their foreign investment while seven thought that they should not be encouraged. 41 respondents did not share their views on this question.
147. One of the suggestions given was that the SFC should align the Principles with those in other jurisdictions or to allow compliance with the Principles by compliance with similar codes or principles in other jurisdictions.

Encouraging foreign investors to commit to the spirit of the Principles

148. Only seven respondents offered their views on the question of how foreign investors in Hong Kong listed companies can be encouraged to commit to the spirit of the Principles in respect of their holdings in Hong Kong companies and whether foreign investors foresee any barriers or difficulties in doing so.
149. Suggestions on how foreign investors could be encouraged to commit to the spirit of the Principles included hosting education and outreach sessions with foreign investors or aligning the Principles with those in other jurisdictions and exempting foreign investors who observe similar codes or principles of other jurisdictions.
150. Views on possible barriers or difficulties preventing foreign investors from committing to the spirit of the Principles included cost or resource constraints, access to Hong Kong listed companies and language barriers.

Potential conflicts with requirements or codes in other countries

151. Only 11 respondents responded to the question of whether there may be any potential conflicts which might arise between requirements or codes in place in other countries and the Principles. Nine respondents did not envisage any potential conflicts on the basis that the Principles are on a “comply-or-explain” basis.
152. Two respondents pointed out possible conflicts:
- (a) trustees and custodians of international financial institutions that have operations in the United States of America could be perceived to be in non-compliance with the Volcker Rule if they retain residual investment power by taking on ownership responsibilities in relation to investments of unit trusts or mutual funds; and
 - (b) some institutional investors are limited by law in places like Japan in the level of direct engagement with investee companies, and asset owners in Canada are not allowed to base divestment decisions solely on economic, social and corporate governance criteria.

Institutional investors' current practices

153. 14 respondents provided responses to the question of what are institutional investors' current practices on disclosing information on their engagement policy, including any national or international standards that are followed. 42 respondents did not provide their views on this question.
154. Respondents currently comply with an array of similar codes or principles of other jurisdictions, such as the UK Stewardship Code, the Japanese Code, the requirement in the United States of America under Form N-PX of the SEC filings, UN PRI and the UK Corporate Governance Code.

155. Respondents' methods of disclosures generally consist of web-based disclosures on their own websites or the website of regulators, offer documents and annual reports. Disclosures currently provided by respondents generally include policies on engagement and engagement protocols, voting practices and policies, description of engagement performed, description of compliance with similar codes of other jurisdictions, description of compliance with each principle or code and a record of all voting performed over a certain time period.

SFC's policy objectives

156. 13 respondents agreed with the policy objectives suggested by the SFC while one respondent disagreed. 42 respondents did not give their views on this question. Respondents also offered other thoughts and comments, but there was no consensus on any of the comments shared.

Monitoring

157. 16 respondents thought that compliance with the Principles should be monitored, of which 13 respondents thought that the SFC should be the regulator that monitors compliance. One respondent thought that the Principles should not be monitored at all. 39 respondents did not offer any views on this question.

Principles of Responsible Ownership

Introduction

1. The Principles of Responsible Ownership (**Principles**) are a set of principles and guidance to assist investors to determine how best to meet their ownership responsibilities.
2. The Principles are non-binding and are voluntary ~~in that they operate on a “comply-or-explain” basis~~. Investors are encouraged to ~~“sign up” to~~adopt the Principles by disclosing to their stakeholders that they have done so, and then they either ~~comply with~~apply the Principles in their entirety and disclose how they have done so, or explain why ~~some or all aspects~~ of the Principles do not, or cannot, apply to them. Investors who do not think that the Principles are relevant to or suitable for them at the outset are encouraged to provide their stakeholders with disclosure which clearly explains why the Principles have not been adopted and, if applicable, explain what alternative measures they have in place.
- ~~3. Investors should avoid stating that they have adopted the Principles but then disclose why each and every Principle does not apply to them. Similarly, where an investor decides not to have a policy on shareholder engagement, they cannot be said to have adopted the Principles. Instead, investors are encouraged to explain to their stakeholders why the Principles have not been adopted at the outset and, if applicable, explain what alternative measures they have in place.~~
- ~~3. The Principles are relevant to individual and retail investors in that they provide guidance on share ownership engagement. Certain elements of the Principles, such as disclosure, reporting and accounting to stakeholders, will not expressly apply to individuals.~~
4. Ownership of shares brings with it important responsibilities, particularly the right to speak and vote on matters that can influence the way in which a business is conducted. Owners of company equity should not blindly delegate these responsibilities. Even when they employ agents, directly or indirectly, to act on their behalf, owners should ensure that their ownership responsibilities are appropriately discharged by those agents.
5. Investors may choose to appoint external service providers to help them perform some of their shareholder engagement activities but they cannot delegate their responsibilities as shareholders to the service providers. In particular, investors remain responsible for ensuring those activities are carried out in a manner consistent with their own policies.

The Principles of Responsible Ownership

6. To discharge their ownership responsibilities investors should engage with the companies in which they invest to promote the long-term success of these companies; investors should:
 - (a) establish and report to their stakeholders their policies for discharging their ownership responsibilities;
 - (b) monitor and engage with their investee companies;
 - (c) establish clear policies on when to escalate their engagement activities;

- (d) have clear policies on voting;
- (e) be willing to act collectively with other investors when appropriate;
- (f) report to their stakeholders on how they have discharged their ownership responsibilities; and
- (g) when investing on behalf of clients, have policies on managing conflicts of interests.

Principle 1

Investors should establish and report to their stakeholders their policies for discharging their ownership responsibilities

7. Investors should establish policies on how they will discharge the ownership responsibilities described in Principles 2 to 7. In determining its policies an investor should consider what policies best reflect its role and the scope of its activities taking into account the costs of implementing a policy. It may be appropriate for an investor to have a nuanced policy that applies different policies to its investments depending on factors such as their size, nature and location.

Stakeholders

8. Where a company or entity invests its own funds, its stakeholders will include the board of directors or equivalent body. Depending on the size and relevance of the overall holdings to the entity, stakeholders may include shareholders. In cases where the entity is accountable to the public, stakeholders may also include the public generally.
9. Where an investor manages clients' funds, stakeholders will include such clients. ~~Insurance companies that issue investment-linked assurance schemes, r~~Retirement funds and investors who accept funds from third parties for investment fall into this category of investors, whether or not they have direct responsibility for investment decisions or appoint third party asset managers to manage their investments.
10. An investor's stakeholders will include the beneficiaries of the funds received from the investor's direct clients. Therefore, where an asset manager is responsible for portfolios of funds on behalf of a retirement fund, ~~an investment-linked assurance scheme~~ or a unit trust holder, the asset manager's stakeholders will include the members of such retirement scheme, ~~the investors in such investment-linked assurance scheme~~ and the holders of such unit trust.
11. The return or value of certain retail investment products, such as investment-linked assurance schemes issued by insurance companies and equity-linked structured products issued by banks, may be linked (directly or indirectly) or calculated with reference to the performance of listed shares in Hong Kong. Whilst investors in these products do not have any rights over or ownership of such shares or funds investing in such shares, the engagement policies of product issuers may be relevant to them. Accordingly, issuers of retail investment products should consider whether investors in such products should be regarded as stakeholders for the purpose of applying the Principles.

Reporting

- 44.12. In deciding how best to report to stakeholders an investor should consider whether it is more efficient to do so generally by disclosure on a website rather than to stakeholders individually.

~~42-13.~~ Where investment activities are outsourced, for instance where funds are placed with asset managers, the report on the engagement policy to stakeholders should disclose what steps are taken to ensure that the ownership responsibilities are discharged in accordance with the policy. Investors should disclose what minimum policy requirements are expected of those discharging ownership responsibilities. An investor should inform its stakeholders how and where its asset managers disclose their policies on discharging ownership responsibility or should include information provided by the asset managers in its reports.

~~43-14.~~ It is generally sufficient for an investor to disclose its ownership responsibility policy when this is established and only update this disclosure when changes are made to the policy.

Principle 2

Investors should monitor and engage with their investee companies.

~~44-15.~~ Investors' ownership responsibilities extend beyond voting. They include monitoring and engaging on matters such as strategy, performance, risk, capital structure and corporate governance. Engagement with investee companies is a process through which shareholders as owners share their views and concerns directly with their investee companies.

~~45-16.~~ Investors should have clear policies on corporate governance principles and practices and on how they will engage with their investee companies if they have concerns about their investee companies' corporate governance practices. Investors should consider carefully any departures from the Corporate Governance Code¹ set out in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Listing Rules**).

~~46-17.~~ Investors should encourage their investee companies to have policies on environmental, social and governance (**ESG**) issues and engage with investee companies on significant ESG issues that have the potential to impact on the companies' goodwill, reputation and performance.

~~47-18.~~ When monitoring companies, investors should aim to:

- (a) keep abreast of the companies' performance;
- (b) keep abreast of developments, both internal and external to the companies, that drive the companies' value and risks;
- (c) satisfy themselves that the companies' leadership is effective;
- (d) satisfy themselves as to the corporate governance structures and practices adopted by the companies;
- (e) consider the quality of the companies' reporting; and
- (f) attend shareholder meetings of companies where appropriate and practicable.

~~48-19.~~ Engagement mechanisms include:

- (a) direct private communication with the companies such as writing letters to and dialogue with management;

¹ Or from other similar codes against which a company discloses its corporate governance practices.

- (b) more public strategies such as using the media and proposing shareholder resolutions at general meetings;
- (c) exercising their rights to speak and vote at general meetings;
- (d) selling their shares; and
- (e) in extreme cases, litigation.

~~49-20.~~ Where the shareholder engagement activities are outsourced, investors should ensure these activities are compatible with the investors' engagement policies and take steps to ensure that these activities are carried out in a manner consistent with their shareholder engagement policies.

~~20-21.~~ Engagement should not include **actively** seeking inside information². Investors should manage their communication with their investee companies or potential investee companies so that they do not obtain inside information that has not been disclosed to the market in accordance with Part XIVA of the Securities and Futures Ordinance (Cap. 571) (SFO) ~~or the Listing Rules~~. When seeking to engage directly with management of an investee company, investors should be aware that the Principles do not give investors the right to information beyond that available in compliance with legislation or regulation. In answering requests for meetings or information investee companies have a duty to ensure that confidential inside information is not leaked and to ensure that investors are treated equally.

~~24-22.~~ Where an investor considers that material information has been provided during discussions with a company, it must implement appropriate mechanisms to ensure that the information is strictly safeguarded and insulated from any other activity. This may include a temporary ban on trading in the company's shares or implementing 'Chinese Walls' until appropriate disclosures have been made to the market. The investor should consider whether it is necessary to warn the company that it may have breached the inside information provisions in the SFO.

Principle 3

Investors should consider and establish clear policies on when they will escalate their engagement activities

~~22-23.~~ Investors' engagement policies should set out the circumstances in which they will actively engage and regularly assess the outcomes of doing so. Shareholder engagement should be considered regardless of whether an active or passive investment policy is followed. Instances when investors may want to engage include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

~~23-24.~~ Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when investors engage them, then investors should consider whether to escalate their action, for example, by:

- (a) holding additional meetings with management specifically to discuss concerns;
- (b) expressing concerns through the company's advisers;
- (c) meeting with the chairman or other board members;

² As defined in Part XIVA of the Securities and Futures Ordinance.

- (d) collaborating with other investors on particular issues;
- (e) making a public statement in advance of general meetings;
- (f) submitting resolutions and speaking at general meetings; and
- (g) requisitioning a general meeting and, in some cases, proposing to change board membership.

Principle 4

Investors should have clear policies on voting guidance

- ~~24-25.~~ Investors should seek to vote all shares held. Where it is not appropriate to vote all shares held, investors should disclose the reasons to their stakeholders. They should not automatically support the board.
- ~~25-26.~~ Unless acting under a client-specific mandate, an institutional investor should vote all shares it holds in a company. Where shares are held for different purposes it may be appropriate for an investor to vote some shares in favour of a resolution and some against. In these cases it should vote all shares and not just a net number.
- ~~26-27.~~ If they are unable to achieve an appropriate outcome through their engagement with an investee company, an investor should abstain or vote against relevant resolutions at shareholder meetings.
- ~~27-28.~~ Where investors use proxy voting or other voting advisory services, they should consider whether the advice reflects their assessments of the issues before voting their shares.

Principle 5

Investors should be willing to act collectively with other investors where appropriate

- ~~28-29.~~ At times collaboration with other investors may be the most effective manner in which to engage.
- ~~29-30.~~ Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.
- ~~30.~~ ~~Investors should indicate their readiness to work with other investors through formal and informal groups where this is necessary to achieve their objectives and to ensure companies are made aware of their concerns. Investors should also indicate the kinds of circumstances in which they would consider participating in collective engagement.~~

Principle 6

Investors should report to their stakeholders on how they have discharged their ownership responsibilities

31. At least annually investors should report to stakeholders on how they have discharged their ownership responsibilities. An investor may choose to give details of its voting on a company by company basis or to report on the extent to which it complies with its stated policy on voting with details of specific cases where significant departures from its stated policy were appropriate.
32. Where investment activities are outsourced, for instance where funds are placed with asset managers, the report on the engagement activities to stakeholders

should disclose what steps have been taken to ensure that the ownership responsibilities are discharged in accordance with the policy. An investor should inform its stakeholders how and where its asset managers disclose their periodic reports on discharging ownership responsibilities or should include information provided by the asset managers in its report.

Principle 7

When investing on behalf of clients, investors should have policies on managing conflicts of interests

33. An investor investing funds on behalf of clients has a duty to act in the interest of its clients and/or the beneficiaries of the funds provided by its clients.
34. Conflicts of interests will inevitably arise from time to time, including votes that directly or indirectly impact the interest of the investor's group, and/or those of a client or the beneficiaries of the funds provided by a client.
35. Institutional investors³ are obliged to have a policy for identifying and managing conflicts of interests in order to ensure that interests of clients, or where applicable the beneficiaries of those funds provided by ~~its~~their clients, are put first. The policy should address how matters are handled when the interests of clients diverge from those of the beneficiaries of the funds provided by ~~its~~their clients. They must manage material conflicts of interests that may affect the exercise of key ownership rights regarding their investments.

³ General Principle 6 of the Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission requires that when conflicts of interests arise a licensed or registered person should ensure that its clients are fairly treated.

List of Respondents

1. Aberdeen Asset Management Asia Limited
2. Allen & Overy
3. APG Asset Management Asia
4. Asian Corporate Governance Association
5. Association for Sustainable & Responsible Investment in Asia
6. Baillie Gifford & Co
7. Baker & McKenzie
8. BlackRock
9. Century Legend (Holdings) Limited
10. CLP Holdings Limited
11. F&C Investments
12. FIL Investment Management (Singapore) Limited
13. Glass Lewis & Co.
14. Great Eagle Holdings Limited
15. gy*
16. Hermes Equity Ownership Services Limited
17. Hong Kong General Chamber of Commerce
18. Hong Kong Investment Funds Association
19. Hong Kong Professionals and Senior Executives Association
20. Hong Kong Securities and Investment Institute
21. Hong Kong Trustees' Association
22. International Corporate Governance Network
23. ITC Properties Group Limited*
24. Kwan, Edward
25. Kwan, Vincent P F Dr
26. Melco International Development Limited**
27. MelcoLot Limited**
28. Mercer Investments (HK) Limited
29. Mn Services N.V.
30. MSCI ESG Research Inc.
31. Mulcahy, Nick
32. Nelson Capital Management on behalf of:
 - (a) Nelson Capital Management
 - (b) Wells Capital Management
33. Overlook Investments Limited
34. PRI Association
35. Private Wealth Management Association Limited

36. PYI Corporation Limited*
37. RS Group endorsed and supported by:
 - (a) Peter Bennett, Chairman, Peter Bennett Foundation
 - (b) Christopher Botsford, Partner and Co-founder, ADM Capital
 - (c) Marc Castagnet, Director, Hill Tribe Organics
 - (d) James Chen, Managing Director, Legacy Advisors Limited
 - (e) Roy Chen, Director, CIO and CEO, Grace Financial Limited
 - (f) Yuk Lynn Chen Woo, Impact Investor
 - (g) Patrick Cheung, Impact Investor
 - (h) Water Cheung, Senior Partner, CEO Asia Pacific, StormHarbour Securities (Hong Kong) Ltd
 - (i) Darius Yuen, Impact Investor
38. Share (Asia Pacific) Limited
39. South Ocean Management, Ltd.
40. Summit Ascent Holdings Limited**
41. The Alternative Investment Management Association Limited
42. The British Chamber of Commerce in Hong Kong
43. The Chamber of Hong Kong Listed Companies**
44. The Hong Kong Association of Banks
45. The Hong Kong Institute of Chartered Secretaries
46. The Hong Kong Society of Financial Analysts
47. The Law Society of Hong Kong
48. Vanguard Investments Hong Kong Limited
49. Webb-site.com
50. Wong Yuen Shan, Stephen
51. WOO, KWAN, LEE & LO
52. Submissions of six respondents requested for their submissions to be published on a “no-name” basis, five of which requested for anonymity altogether.

* These submissions were received past the consultation period without having been granted time extension to the deadline, but their submissions were nevertheless considered as part of the consultation conclusions.

** These respondents’ second submissions were received past the consultation period without having been granted time extension to the deadline, but their submissions were nevertheless considered as part of the consultation conclusions.