恒生指數
HANG SENG INDEXES

CONSULTATION PAPER

1) Positioning of the Hang Seng Index ("HSI")
2) Eligibility of Weighted Voting Right Companies ("WVRs") for the HSI
3) Eligibility of Secondary-listed Companies for the HSI
4) Weighting of the Financials Sector in the HSI
5) Matters Related to the Hang Seng China Enterprises Index ("HSCEI")

January 2020

(Data as of 31 December 2019 and sourced from Hang Seng Indexes Company Limited unless otherwise specified)

Note:
The information and questions in this document are for the sole purpose of gathering opinions from market participants and various stakeholders. Changes to the relevant indexes, if any, will be announced at a later date.

Responding to the Consultation

Please send us your responses to research@hsi.com.hk **by 13 March 2020**. Thank you.

All responses will be kept strictly confidential and used solely for the purposes of internal research and discussion by Hang Seng Indexes Company Limited ("Hang Seng Indexes").

If you wish to provide your responses in hardcopy format, please mail to:

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Respondent Details

In order to better understand your valuable opinions, we may further contact you via e-mail and / or phone for follow-up after you return your responses. Please provide your contact information for this purpose. Failure to provide valid contact details may result in your responses being excluded from this consultation. Thank you.

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Date: March 12, 2019

** Please provide at least one channel through which you can be contacted*

Important Note

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Background

- Created in 1969, the HSI was originally designed to represent the Hong Kong stock market by reflecting the performance of the largest and most liquid companies within the market.

- Over the past 50 years, the Hong Kong stock market has evolved and become significantly more layered and sophisticated.

- Geographically, the market has shifted from being locally focused to having a more diverse exposure, with over half of the market, in terms of capitalisation, now attributable to mainland China enterprises. A number of foreign companies, including several well-known international companies, have also listed in Hong Kong for various reasons.

- In recent years, the Stock Exchange of Hong Kong ("SEHK") has established new listing chapters to accommodate companies in innovative or new economy sectors that might otherwise be unable to list under the previous rules. Examples include biotech companies, WVRs and companies from the Greater China region (i.e. Hong Kong, Mainland, Macau and Taiwan) seeking a secondary listing.

- Following a market consultation in 2018, Hang Seng Indexes broadened the eligibility universe of the Hang Seng Composite Index ("HSCI"), which is a comprehensive Hong Kong market benchmark that covers about the top 95th percentile of the total market capitalisation of companies listed on the Main Board of SEHK, to include foreign companies, stapled securities and WVRs. The potential eligibility of these issuers for inclusion in the HSI requires further review.

- The HSI is widely used for a variety of purposes, including gaining exposure to the Hong Kong stock market, serving as the underlying index for various derivatives and structured products, and providing a benchmark for retirement investment schemes. To balance the needs of different stakeholders, Hang Seng Indexes exercises a prudent approach in responding to the evolution of the Hong Kong market.

- In this consultation, Hang Seng Indexes wishes to solicit market feedback on:

  1) The positioning of the HSI
  2) The eligibility of WVRs for the HSI
  3) The eligibility of secondary-listed companies for the HSI
  4) The weighting of the Financials sector in the HSI
  5) Matters related to the HSCEI

1) Positioning of the HSI

1.1 Launched in 1969, the HSI was developed to provide a benchmark of the Hong Kong equity market and thus the city's economic development. Initially, the HSI included only 33 constituents – essentially, the largest and most actively traded companies listed in Hong Kong at that time. As of the date of this consultation paper, five of the original Blue-chip constituents remain in the index.

1.2 In the past 15 years, the Mainland segment of the Hong Kong stock market has grown significantly. Around 60% of the companies currently listed in Hong Kong are Mainland companies (i.e. companies with more than 50% of the revenue derived from the Mainland in general), and they account for about 70% and 80% of the market in terms of market capitalisation and trading respectively.

Exhibit 1: Number of Listed Companies by Geographical Classification (2004 – 2019)

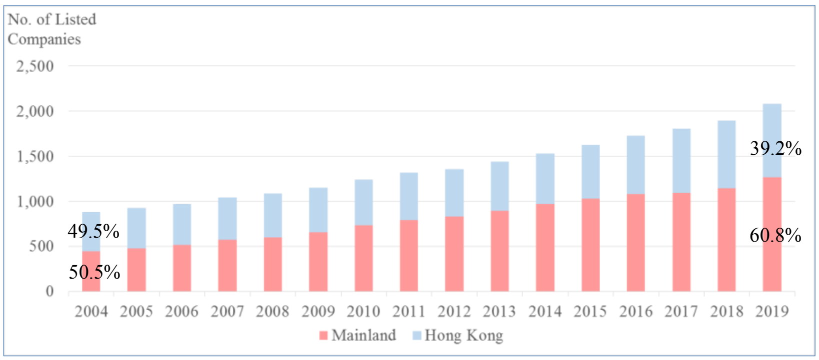


Exhibit 2: Market Capitalisation by Geographical Classification (2004 – 2019)

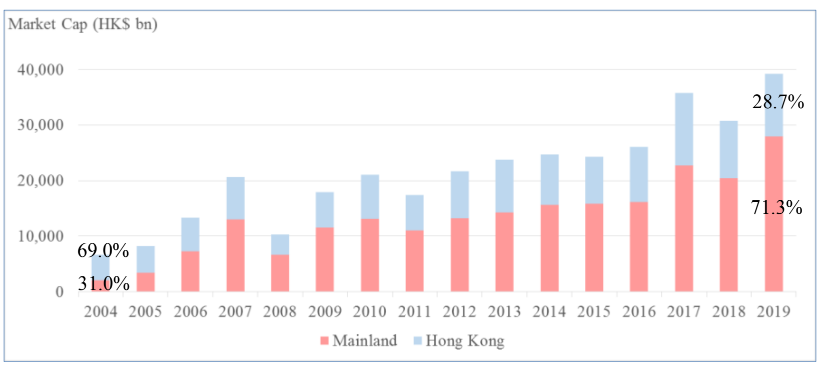
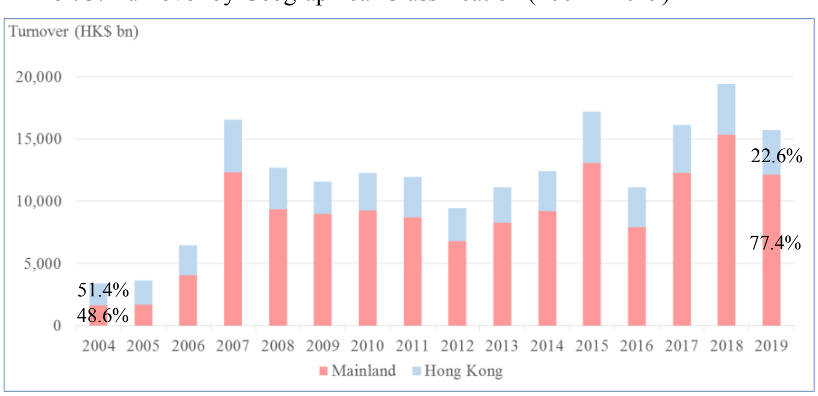


Exhibit 3: Turnover by Geographical Classification (2004 – 2019)



1.3 Since its early years as a market benchmark, the uses of the HSI have significantly expanded in line with the development of the financial market. For example:

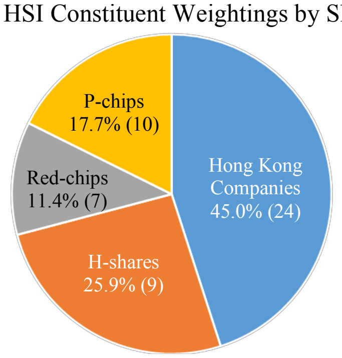
- There are currently 23 exchange-listed products tracking the HSI with listings on 10 stock exchanges across the world, representing more than US$20 bn in assets under management.
- On average, over 280,000 HSI futures and options contracts were traded in Hong Kong daily in 2019, with a notional open interest of US$61 bn as at the end of 2019.
- The amount of Mandatory Provident Fund assets in Hong Kong tracking the HSI is about US$8 bn.

1.4 The HSI's methodology has been refined and revised over the years in response to market developments, with the aim of trying to maintain the original core objectives of the index while also recognising the evolution of financial markets in Hong Kong and the need to accommodate the new needs and priorities of HSI stakeholders. At every stage, however, care has been taken to consider changes to the HSI in a prudent manner.

Exhibit 4: Major HSI Milestones

Year	**Event**
1969	HSI is officially launched to the public (with 33 constituents)
1994	Guangzhou Investment becomes the first Red-chip company to be included in the HSI
2006	• HSI calculation methodology is changed to freefloat-adjusted market-capitalisation weighted (from full market-capitalisation weighted) • Maximum number of HSI constituents is increased to 38 • China Construction Bank becomes the first H-share company to be included in the HSI
2007	Maximum number of HSI constituents is further increased to 50
2012	Number of HSI constituents reaches 50
2014	Link REIT becomes the first real estate investment trust to be included in the HSI

Exhibit 5: HSI Constituent Weightings by Share Type



(X) Number of companies

1.5 With 50 constituents, the HSI now covers around 55% of the market capitalisation and 50% of the traded value of all companies listed on the Main Board of SEHK, excluding foreign companies.

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Your views:

Question 1:

What do you think the HSI should now represent given the significant development and evolution of Hong Kong stock market over the past 50 years? (Select one answer only)

☐	Largest and most liquid Hong Kong-listed stocks, regardless their geographical exposure or nationality (potentially also include foreign companies)
☐	Hong Kong-listed companies from Greater China region (i.e. Hong Kong, Mainland, Macau and Taiwan)
☐	Hong Kong-listed companies that reflect the Hong Kong economy
☐	Others, please specify ______________________________

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

Question 2:

Do you think there is a need to maintain a reasonable balance between Hong Kong# and non-Hong Kong constituents in the HSI? (Select one answer only)

☐	Yes, there should be a reasonable balance between Hong Kong and non-Hong Kong constituents in the HSI in terms of (Select one answer only) ☐ Number of constituents ☐ Weighting for Hong Kong and non-Hong Kong constituents
☐	No, the natural distribution of Hong Kong and non-Hong Kong constituents in the HSI according to the existing methodology is fair and representative

"Hong Kong" companies are those companies that are not foreign companies or Mainland companies as defined by Hang Seng Indexes

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

Question 3:

How would you rank the following considerations in deciding changes of HSI constituents? (1 – most important; 3 – least important)

Rank	Consideration
1	Market representativeness – for transparency's sake the largest and most liquid companies should be selected even if they may qualify as constituents at their peak price
3	Growth potential – tech-related or emerging sector companies that may not be among the largest stocks but that may possess longer-term potential should not be disadvantaged in constituent selection
2	Others (e.g. fundamental criteria, ESG performance, etc.), please specify ______________________

Please provide your reasons, comments and suggestions

Index providers, such as Hang Seng, have long applied discretion to carefully construct indexes. While indexes are designed to represent the market, premier indexes such as HSI must make methodological determinations in order to ensure broad exposure without covering the entire market in an indiscriminate way. Methodology that ignores voting rights would be a stark exception to this careful approach. While stock exchanges, regulators and global regulatory coordinators have not adequately responded to the growing separation of ownership and control, index providers are well positioned to apply the alignment principle broadly and respond to long-term, fundamental shifts in public capital markets that make voting rights an important component of index methodology. Recently S&P Dow Jones acted in this manner by barring the addition of WVR companies to the S&P 1500 index and its components.

2) Eligibility of WVRs for the HSI

2.1 The first WVR listed in Hong Kong in July 2018. As at the end of 2019, there were three WVRs listed in Hong Kong.

Exhibit 6: WVRs Listed on the SEHK

Stock Code	Company Name	Listing Date	Industry	Market Cap (HK$ bn)	Market Cap Rank*
1810	Xiaomi	9 Jul 2018	Telecommunications Equipment	259.0	27
3690	Meituan	20 Sep 2018	E-Commerce & Internet Services	591.8	8
9988	Alibaba	26 Nov 2019	E-Commerce & Internet Services	4,446.9^	1

* Rank among all stocks listed on the SEHK

^ In the HSCI, market capitalisation is measured by the proportion of shares registered in Hong Kong

2.2 There is a diverse range of market views over the index eligibility of WVRs. As these entities are usually large technology-related Mainland companies with global business interests, advocates see them as an excellent investment opportunity that is too good to ignore. Further, from the perspective of market representation, it seems inappropriate to exclude these large-cap companies from key benchmark indexes.

2.3 On the other hand, opponents have raised concerns about the unequal voting right structure of WVRs, which might disadvantage general shareholders given the superior voting rights of certain 'minority' shareholders.

Your views:

Question 4:

Do you think WVRs should be eligible for inclusion in the HSI? (Select one answer only)

☐	Yes, WVRs should be eligible
☑	No, WVRs should not be eligible unless they meet additional criteria, e.g. Either a sunset provision of 7 years or less on WVRs or Weighting based on proportion of voting power in the hands of non-strategic holders
☐	No, WVRs should never be eligible (Skip Question 5)

Please provide your reasons, comments and suggestions

We generally agree that WVRs "disadvantage general shareholders given the superior voting rights of certain 'minority' shareholders." A body of research shows that the harms of misalignment tend to manifest after the earliest stage of a company's public life.* A reasonable sunset would permit those relying on the index to capture early-stage public growth, while assuring long-term accountability to shareholders. Incorporating the proportion of total voting power in free float hands in the weighting of index constituents could also help reflect the importance of voting power while still allowing for greater market representativeness.

*See Kim, Michaely, "Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures", 2018, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209. See also the working paper of Cremers, Lauterbach and Pajuste, "The Life-Cycle of Dual Class Firms," 2017, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895

Question 5:

If WVRs are to be added to the HSI, do you think there is any need to limit their proportion in the index? (Select one answer only)

☑	Yes, WVR constituents should be limited in terms of (Allow multiple selection) ☐ Total number of constituents ☐ Aggregate weighting in the HSI ☑ Discounted individual weighting (e.g. adopt a common discount factor of 0.5 to all WVR constituents)
☐	No, WVRs should be treated the same as other HSI constituents

Please provide your reasons, comments and suggestions

As discussed above, we believe it would be appropriate to discount individual weighting of a listed company that has WVRs based on the proportion of voting power in free float hands. Although it was not ultimately enacted, MSCI considered this approach and proposed incorporating the proportion of total voting power in the hands of non-strategic shareholders of listed securities into each security's float-adjusted market cap contribution to its developed and emerging market indexes.

3) Eligibility of Secondary-listed Companies for the HSI

3.1 Primary-listed companies are fully subject to the listing rules of the SEHK. In contrast, secondary-listed companies are principally regulated by the jurisdiction where they are primary listed. Certain SEHK listing rules are waived for secondary listings based on an understanding that shareholder protection standards that are in place in the overseas primary market are at least as stringent as those in Hong Kong. Historically, trading in these secondary-listed foreign companies has been fairly weak in Hong Kong.

3.2 In 2018, the SEHK introduced a new concessionary secondary listing route, Chapter 19C, for Greater China companies that would like to consider Hong Kong for a secondary listing. Before the introduction of Chapter 19C, Greater China companies were not allowed to seek a secondary listing in Hong Kong to prevent potential regulatory arbitrage.

3.3 Alibaba is the first overseas issuer to secondary list in Hong Kong based on Chapter 19C, and it is expected that more Greater China companies with a primary listing overseas will come to Hong Kong for secondary listing.

3.4 Many of the Greater China companies that seek a secondary listing in Hong Kong would be more familiar to Hong Kong investors, and this is expected to drive an upturn in interest in trading these stocks.

Exhibit 7: Secondary-listed Companies in Hong Kong

Stock Code	Company Name	Listing Date	Primary Exchange	Greater China or Foreign Companies	Market Cap (HK$ bn)	Average Daily Traded Value* (HK$ mn)
945	Manulife	27 Sep 1999	Toronto	Foreign	303.0	2.65
1878	SouthGobi	29 Jan 2010	Toronto	Foreign	0.2	0.04
6288	Fast Retail	5 Mar 2014	Tokyo	Foreign	23.0	0.21
9988	Alibaba	26 Nov 2019	New York	Greater China	4,446.9^	2,496.64

* Average daily traded value in December 2019
^ In the HSCI, market capitalisation is measured by the proportion of shares registered in Hong Kong

Your views:

Question 6:

Do you think secondary-listed Greater China companies should be eligible for inclusion in the HSI? (Select one answer only)

☐	Yes, secondary-listed Greater China companies should be eligible
☐	No, secondary-listed companies should not be eligible unless they meet additional criteria, e.g. ____________________ ____________________

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☐	No, secondary-listed companies should never be eligible (Skip Question 7)

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

Question 7:

If secondary-listed Greater China companies are to be added to the HSI, do you think there is any need to limit their representation in the index? (Select one answer only)

☐	Yes, secondary-listed constituents should be limited in terms of (Allow multiple selection) ☐ Total number of constituents ☐ Aggregate weighting in the HSI ☐ Discounted individual weighting
☐	No, secondary-listed companies should be treated the same as other HSI constituents

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

4) Weighting of the Financials Sector in the HSI

4.1 Financials has been a dominant segment in the HSI for some time. As at the end of 2019, there were 11 finance stocks in the index, which collectively accounted for nearly half of the index weighting. Also of note, the aggregate weighting of Financials in the HSI was about 14 percentage points higher than its weighting in the HSCI.

Exhibit 8: Comparing Sector Distribution between the HSI and the HSCI

Sector	Aggregate Weighting (%)		Difference (percentage points)
	HSI	HSCI	
Financials	**48.3**	**34.0**	**+14.3**
Utilities	4.6	5.2	-0.6
Properties	11.0	12.6	-1.6
Commerce and Industry	36.1	48.2	-12.1

4.2 Hang Seng Indexes conducted an opinion survey on similar Financials sector issues in 2010. The results of the 2010 survey indicated that most respondents were not concerned with the situation, and that the majority of them did not support placing constraints on sector weightings. In light of these findings, Hang Seng Indexes concluded no change was appropriate at that time.

4.3 Since 2010, a growing number of market participants have begun to express concerns over the heavy weighting of Financials in the HSI.

4.4 In view of this, Hang Seng Indexes is revisiting the issue and considering if it is now appropriate for the HSI to adopt sector capping, i.e. set a ceiling for the allowable aggregate weighting for any sector in the HSI.

Your views:

Question 8:

Do you think the weighting of the Financials sector in the HSI is an issue that needs to be addressed? (Select one answer only)

☐	Yes, I think it should be addressed
☐	No, I do not consider this is an issue (Skip Question 9)

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

Question 9:

Is sector capping a good way to prevent any sector(s) from overly dominating the HSI? (Select one answer only)

☐	Yes, I think it would help resolve the problem
☐	No, I believe other methods would be more effective (Allow multiple selection) ☐ Limiting the number of constituents in any particular sector ☐ Applying sector-specific caps on individual constituent weightings (e.g. 8% for Financials constituents, 10% for constituents in other sectors) ☐ Others, please specify ___________________________

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

5) Matters Related to the HSCEI

Eligibility of WVRs and Secondary-listed Companies for the HSCEI

5.1 Similar to the HSI, the HSCEI index universe does not currently include WVRs and secondary-listed companies.

5.2 Given recent market developments, it is expected that there will be more Mainland WVRs and / or secondary-listed companies coming to list in Hong Kong in the future. To continue to exclude these companies from the HSCEI may therefore have an increasingly significant adverse effect on the HSCEI's representativeness as the 'China Index of the Hong Kong Market'.

Your views:

Question 10

Do you think WVRs should be eligible for inclusion in the HSCEI? (Select one answer only)

☑	Yes, WVRs should be eligible
☐	No, WVRs should not be eligible

Please provide your reasons, comments and suggestions

As explained in the answers to questions 4 and 5, we believe WVRs should be eligible for inclusion in the HSCEI if the companies adopt either a sunset provision of 7 years or less or if the proportion of voting power in the hands of non-strategic holders is incorporated into the weighting of constituents of HSCEI.

Question 11:

Do you think secondary-listed companies should be eligible for inclusion in the HSCEI? (Select one answer only)

☐	Yes, secondary-listed companies should be eligible
☐	No, secondary-listed companies should not be eligible

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

Additional Eligibility Screenings for Red-chips and P-chips in the HSCEI

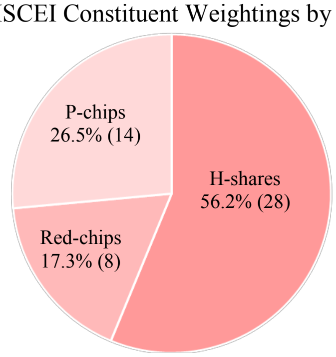
5.3 When Red-chips and P-chips are considered for inclusion into the HSCEI, they are subject to additional screening on certain eligibility aspects as set out below:

- Listing history
- Price volatility
- Financial performance, i.e.
  - Net profit attributable to equity holders of the company
  - Net cash generated from operating activities
  - Cash dividends

5.4 The above requirements were introduced when Red-chips and P-chips were first added to the HSCEI in 2018 due to the concern that they might have very different risk profiles from H-shares, which, until 2018, were the only class of shares included in the HSCEI. These additional eligibility criteria are only imposed on Red-chips and P-chips that are being considered for inclusion in the HSCEI and are not applied to existing constituents.

5.5 More than a year from this expansion of the HSCEI universe, the index now includes a fair mix of H-shares, Red-chips and P-chips. Hang Seng Indexes is therefore proposing to remove the extra conditions currently imposed on Red-chips and P-chips in order to have a single set of eligibility criteria for all share classes so that constituents are selected more in line with the objectives of the index.

Exhibit 9: HSCEI Constituent Weightings by Share Type



(X) Number of companies

Your views:

Question 12:

Should the extra eligibility conditions that currently apply to Red-chips and P-chips be removed? (Select one answer only)

☐	Yes, the extra eligibility conditions that currently apply to Red-chips and P-chips should be removed
☐	No, the extra eligibility conditions that currently apply to Red-chips and P-chips are fine and there is no need to make any changes at this time

Please provide your reasons, comments and suggestions

CII generally does not express a view on this matter.

~ Thank you ~

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