

Listings of Innovative Companies in Hong Kong - the New Regime

March 2018

In December 2017, The Stock Exchange of Hong Kong Limited (the **Exchange**) released its highly-anticipated **New Board Concept Paper Conclusions** (the **First Conclusions**), in which it announced reforms to attract high-growth innovative companies to list in Hong Kong. After further consultation with the Securities and Futures Commission (SFC) and other stakeholders, the Exchange has now issued a second-stage **consultation paper** (the **Second Paper**), which: (1) confirms the Exchange intends to follow the proposals described in the First Conclusions (with certain refinements); (2) contains draft wording for the new rules; and (3) seeks market feedback to put the “finishing touches” on the proposals and the new rules.

The Exchange is aiming to implement the new rules in late April.

The new regime will take the form of three new chapters to the Listing Rules, addressing: (1) primary listings of companies with weighted voting rights (**WVRs**); (2) primary listings of pre-revenue biotech companies; and (3) secondary listings of qualifying companies (with or without WVRs) under a concessionary route, in each case on the Main Board.

WVR companies - primary listing

Part A - qualifications for listing

The suitability and eligibility criteria for listing with WVRs (summarised below) largely follow those described in the First Conclusions but some additional colour has been given in the Second Paper on the meaning of “innovative”. The Exchange has

also now specified the minimum level of economic interest which WVR beneficiaries must hold upon listing.

Under the regime, only individuals (who are directors) can be WVR beneficiaries. Notably, the Exchange has decided to separately consult on whether corporate WVR beneficiaries should also be permitted and what the safeguards should be. Corporate groups interested in spin-offs should keep a close eye on this separate consultation.

1

Considered suitable for listing by demonstrating:

- (A) A WVR applicant is “innovative”, which can normally be demonstrated if it possesses more than one of the following characteristics:
- success being attributable to the application of new technologies, innovations and/or business models to the core business, which also differentiates it from existing players;
 - R&D being a major contributor of expected value and expense;
 - success being attributable to unique features or intellectual property; and/or
 - an outsized market cap/intangible asset value relative to tangible asset value.

Note: the Exchange will have a high degree of discretion on suitability. The suitability criteria (including the “innovative” requirement) is expected to be contained in guidance letters, which will give the Exchange flexibility in updating the criteria going forward.

Whilst the Exchange will take the frontline role in assessing innovation and suitability, the SFC can also be expected to have a role via its right to raise queries with or object to listing applications under the “SMLR grounds” (the key one being where the listing would not be in the “public interest”).

The Second Paper gives some additional colour on the meaning of “innovative”: (i) an innovative business model may cease to be so once adopted by numerous competitors; (ii) an innovative way of deploying existing technology or a new way of connecting consumers and providers may qualify; and (iii) a superficial application of new technology to an otherwise conventional business will not qualify (e.g. a retail business with an online sales platform may not qualify without other distinguishing features).

Given what is innovative will change rapidly and the requirement to be innovative does not apply post-listing, this may encourage certain applicants to apply for listing as soon as possible.

- (B) Trajectory of high business growth which is expected to continue.
- (C) Where a company’s value is largely due to intangible human capital, WVR holders have been materially responsible for the growth of the business.
- (D) Each WVR holder is an individual with an active executive role and will be a director upon listing.
- (E) Funding from at least one sophisticated investor, who would be subject to a 6 month lock-up of 50% of their investment.

Note: the requirement for sophisticated investor funding does not apply to a spin-off applicant.

2

Minimum market capitalisation at listing

- (A) Market capitalisation of at least HK\$40 billion; or
- (B) Market capitalisation of at least HK\$10 billion and revenue of at least HK\$1 billion for most recent audited financial year

3

Minimum and maximum economic interest at listing

All WVR beneficiaries must collectively own a minimum of 10% and maximum of 50% of the underlying economic interest in the company’s total issued share capital at listing.

Note: the cap only applies at listing and not afterwards, and a lower minimum threshold may be acceptable on a case by case basis (e.g. if the market capitalisation is over HK\$80 billion).

4

Be a new applicant

Part B - mandatory WVR safeguards

Unlike the US, WVR companies primary listing in Hong Kong must adopt certain investor safeguards and build them into their constitutional documents. However, as mentioned below, these safeguards (except disclosure-related ones) are not required to be adopted by certain WVR companies that secondary list in HK under the new secondary listing route.

The Second Paper adopts the safeguards described in the First Conclusions (with some additional clarifications) and it remains the case that no time-defined sunset clause will be imposed.

1

Restriction to share class based WVR structure

WVRs must be attached to a class of equity securities (which must be unlisted) and the only difference in rights between WVR shares and non-WVR shares is the former conferring enhanced voting power at general meetings

Note: Control mechanisms that are not through outsized voting power (such as a special ability to nominate a majority of the board) will accordingly not be permitted, save on certain secondary listings as mentioned below.

The above means WVR companies that primary list in HK will fit within the existing “control” test of the Hong Kong Takeovers Code as that test is by reference to voting rights.

2

Requirements on voting rights

- (A) Voting power of WVR shares cannot be more than 10 times the voting power of non-WVR shares
- (B) Non-WVR holders must hold at least 10% of votes
- (C) Terms of WVR shares cannot be altered post-listing to increase voting power
- (D) Ability for general meeting to be convened by non-WVR holders holding 10% of votes on a one-share-one-vote basis
- (E) Following decisions must be made on a one-share-one-vote basis:
 - i. change to constitutional documents
 - ii. variation of class rights
 - iii. appointment and removal of independent non-executive directors
 - iv. appointment and removal of auditors
 - v. voluntary winding-up

3

Restrictions on increase of WVR shares

- (A) No post-listing increase of the proportion of WVR shares
- (B) Limited right to issue WVR shares post-listing (pursuant to a pro-rata offer to all shareholders or capital reorganisation), provided there is no increase in the proportion of WVR shares

Note: accordingly, post-listing issues of WVR shares are only permitted to prevent dilution of WVRs. If WVR beneficiaries under a pro-rata offer do not take up any of the WVR shares, they cannot be offered to any other person.

- (C) If there is a reduction in the number of issued shares (e.g. through a share repurchase), there must be a proportionate reduction of WVRs

4

Mandatory lapse of WVRs attached to a beneficiary's shares

- (A) If the WVR beneficiary dies, is no longer a member of the board, incapacitated or no longer meets the requirements of a director (e.g. convicted of offence involving fraud / dishonesty)
- (B) Upon any transfer to another person of the beneficial ownership of, economic interest in or control over voting rights attached to the WVR shares

Note: the mandatory conversion of WVR shares to non-WVR shares upon a transfer means an offeror under a takeover, or lender enforcing a share charge, would only be able to acquire non-WVR shares from a WVR beneficiary.

There is no carve-out for transfers to a fellow WVR beneficiary. However: (i) an encumbrance over WVR shares which does not result in a transfer of legal or beneficial ownership or voting rights would not be considered a “transfer”; and

(ii) putting in place or amending “holding arrangements” post-listing (i.e. holding WVR shares through a limited partnership, trust or other vehicle) would be acceptable provided it is not a circumvention of the “transfer” restriction. The Second Paper envisages such arrangements may be in place for tax or estate planning purposes for individual WVR beneficiaries only.

5 Enhanced Corporate Governance

- (A) A corporate governance committee comprising a majority of INEDs to ensure the company is being managed for the benefit of all shareholders and is complying with the investor safeguards

Note: INEDs of WVR issuers will thus have a higher duty of care than those of non-WVR issuers.

- (B) A permanent compliance adviser
- (C) Certain provisions of the Corporate Governance Code (regarding the role of the INED, establishment of a nomination committee, retirement of INEDs once every three years) will be mandatory
- (D) Nomination committee will be solely responsible for making recommendations to the board on INED nomination
- (E) WVR beneficiaries are deemed to be “connected persons” and “core connected persons” of the listed issuer
- (F) Training for the board and senior management on WVR and its associated risks

6 Enhanced disclosure

- (A) Unique stock marker
- (B) Prominent disclosure of WVR structure and risks on listing documents, financial reports, circulars and announcements

- (C) Disclosure of WVR beneficiaries in listing documents, interim and annual reports

Biotech companies - primary listing

The Second Paper follows the First Conclusions in allowing early-stage biotech companies to primary list without meeting the usual profit or revenue track record requirements. The Exchange has clarified applicants that have developed at least one commercial product / process with a medical or biologic application (e.g. a pharmaceutical or biologic product or a medical device) beyond the concept stage may be considered suitable, provided the product is subject to regulation by recognised authorities. Currently, the US’ FDA, PRC’s CFDA and the EU’s EMA are recognised for this purpose.

Other requirements include: (1) a minimum expected market capitalisation of HK\$1.5 billion; (2) at least 12 months of R&D of the core products; (3) a pipeline of potential products if it is engaged in the R&D of pharmaceutical or biologic products; (4) at least one sophisticated investor six months prior to the listing (who must remain on IPO); (5) enhanced working capital, i.e. 125% of the applicant’s current requirements over the next 12 months; and (6) current line of business having been in operation for at least two years prior to listing.

For further details, please refer to our separate [biotech briefing](#).

Secondary listings

Another key reform is a concessionary route to secondary listings which partially lifts the blanket ban on the secondary listings of companies with a Greater China “centre of gravity” (**Greater China Companies**). The changes are expected to pave the way for PRC new economy giants already listed in the US to secondary list in Hong Kong without having to alter their WVR structures.

The Second Paper largely follows the proposals described in the First Conclusions, with some notable changes as described below.

Part A - qualifications for secondary listing

1	Considered suitable for listing by demonstrating:
	(A) It is “innovative” (see characteristics in 1(A) of Part A above)
	<i>Note: innovative companies can secondary list even if their centre of gravity is in Greater China.</i>
	<i>The First Conclusions stated the same suitability assessment on a WVR primary listing would apply to a WVR secondary listing. However, aside from “innovative”, the Second Paper does not appear to apply the remaining suitability criteria (see 1(B) to 1(E) in Part A above) to a secondary listing (e.g. trajectory of continuing high business growth, WVR holder is an individual with an active executive role, and sophisticated investor funding).</i>
	(B) If it has a WVR structure, it is not an extreme departure from governance norms
	<i>Note: an example of an extreme departure is ordinary shares that carry zero voting rights (such as the US-listed Snap Inc.). A non-share based control structure is not cited as an example of an extreme departure.</i>
2	Minimum market capitalisation at secondary listing
	(A) For non-Greater China Companies, market capitalisation of at least HK\$10 billion
	(B) For WVR companies and/or Greater China Companies:
	i. market capitalisation of at least HK\$40 billion; or
	ii. market capitalisation of at least HK\$10 billion and revenue of at least HK\$1 billion for most recent audited financial year

3 Primary listing on a Qualifying Exchange

- (A) New York Stock Exchange;
 (B) NASDAQ; or
 (C) Premium segment of the London Stock Exchange

4 Good compliance record of 2 years on a Qualifying Exchange**Part B - concessions**

Companies that meet the above criteria will be able to secondary list on the Main Board with the following concessions:

1 Benefit of certain codified waivers

This would include waivers from HK rules on (amongst others):

- (A) connected transactions
 (B) notifiable transactions

2 Concession on WVR investor safeguards

The following WVR companies would not be required to adopt WVR investor safeguards (except disclosure-related safeguards):

- (A) Greater China Companies that primary listed prior to 15 December 2017 (being the date of the First Conclusions) (**Grandfathered Greater China Companies**); and
 (B) non-Greater China Companies (irrespective of when it primary listed)

Note: non-grandfathered Greater China Companies cannot benefit from this concession. However, all applicants listing under this route must demonstrate equivalence with the “Key Shareholder Protection Standards” (e.g. AGM at least every 15 months, super-majority vote on certain fundamental decisions). Non-grandfathered Greater China Companies must amend their constitutional documents as

necessary to meet these standards. The Exchange “may require” Grandfathered Greater China Companies and non-Greater China Companies to do likewise - this is a stricter position than under the First Conclusions.

3

Concession on VIE structures

Grandfathered Greater China Companies and non-Greater China Companies can secondary list with their existing VIE structures in place, subject to providing a legal opinion on the VIE’s compliance with laws and regulations and certain disclosure requirements

Note: this is a new concession in the Second Paper that is not available to non-grandfathered Greater China Companies.

However, if the bulk of trading of a company that secondary listed under this route migrates to Hong Kong (i.e. 55% of the total trading volumes in its shares takes place on the Exchange in the most recent fiscal year):

- (1) the original waivers (primarily relating to Hong Kong notifiable / connected transaction rules) would fall away after a one year grace period (to be replaced by waivers normally granted for dual primary listings). However, this would not apply to non-Greater China Companies who would continue to benefit from the original waivers; and
- (2) the Hong Kong Takeovers Code would apply at that point - it will be interesting to see how the SFC will apply the Takeovers Code to WVR companies whose control structures are not share-based or whose WVRs will not lapse upon a transfer to an offeror.

The concessions on WVR safeguards and VIE structures will continue to apply even if the bulk of trading of a Grandfathered Greater China Company or non-Greater China Company migrates to Hong Kong. This is a relaxation from the previous position - the Exchange had initially proposed WVR safeguards would be required to the extent they are not inconsistent with the company’s existing governance structures.

Next Steps

The deadline for responding to the Second Paper is 23 March 2018. The Exchange is targeting late April for the conclusions to be published and for the new rules to become effective. Companies may submit formal pre-IPO enquiries from the date the conclusions are published, and formal listing applications from the date the new rules become effective. Before then, the Exchange will respond to enquiries on an informal basis.

It will be interesting to see the guidance letter on the concept of “innovative”, as well as any proposals from the SFC on the application of the Takeovers Code to secondary listed companies whose WVR or control structures are not easily accommodated under the existing framework of the Takeovers Code. After the implementation of the Rules, the next big step to monitor will be the Exchange’s consultation on corporate WVR holders.

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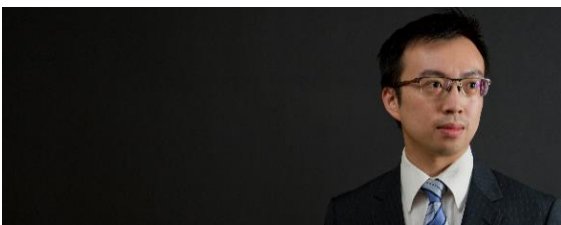
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