

Hong Kong Capital Markets Update

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HKEX consultation conclusions on the New Board Concept Paper and Growth Enterprise Market (GEM) reform

On 15 December 2017, the Hong Kong Stock Exchange (the Exchange) published conclusions to its earlier consultations on a package of proposals to reform Hong Kong's listing regime through the [New Board Concept Paper](#) and the [Consultation Paper on the review of the Growth Enterprise Market \(GEM\) and Changes to the GEM and Main Board Listing Rules](#) (please refer to our [Capital Markets Update](#) published in June 2017 for a summary of the objectives and the proposals).

This Capital Markets Update provides an overview of the conclusions to the consultations on these two papers.

Highlights: Conclusions on the New Board Concept Paper

- The Exchange will extend the existing listing regime by introducing two new chapters to the Main Board Listing Rules, to allow the listing of:
 - i) pre-revenue Biotech issuers with a minimum expected market capitalisation at the time of listing of HK\$1.5 billion; and
 - ii) issuers from emerging and innovative sectors that have weighted voting right (WVR) structures, subject to additional disclosures and safeguards.
- Companies with WVR structures would be required to have a minimum expected market capitalisation of HK\$10 billion at the time of listing and, if they have a market capitalisation of less than HK\$40 billion, would need to meet a revenue requirement of HK\$1 billion in the full financial year before listing.
- The Exchange also proposes to amend the Main Board Listing Rules (and also make consequential changes to the 2013 Joint Policy Statement) to create a new concessionary secondary listing route, to attract issuers from emerging and innovative sectors that have a primary listing on the NYSE, NASDAQ or the "premium listing" segment of the LSE's Main Market.
- The Exchange expects to proceed with the formal consultation on the proposed rule amendments in the first quarter of 2018.



Highlights: Review of the GEM and changes to the GEM and Main Board Listing Rules

Amendments to the GEM listing requirements

- Remove the streamlined process for transfers to the Main Board with transitional arrangements.
- Increase the cashflow requirement from HK\$20 million to HK\$30 million.
- Increase minimum expected market capitalisation at the time of listing from HK\$100 million to HK\$150 million.
- Increase the minimum public float value from HK\$30 million to HK\$45 million.
- Require the mandatory public offering of at least 10 percent of the total offer size.
- Extend the post-IPO lockup requirement so that the controlling shareholder (a) cannot dispose any of their equity interest within the first year of listing; and (b) cannot dispose any interest in the subsequent year that would result in them no longer being a controlling shareholder.

Amendments to the Main Board listing requirements

- Increase the minimum expected market capitalisation at the time of listing from HK\$200 million to HK\$500 million.
- Increase the minimum public float value from HK\$50 million to HK\$125 million.

Main Board and GEM listing applications will continue to be processed in accordance with current requirements until 14 February 2018. New applications submitted on or after 15 February 2018 – the Rule Amendment Effective Date – will be processed under the **amended** rules.

Conclusions on the New Board Concept Paper

Based on the feedback from market stakeholders, the Exchange has decided to expand Hong Kong's listing regime to facilitate listings of companies from emerging and innovative sectors. The Exchange will abandon its earlier plan to have a New Board to accommodate New Economy¹ companies, and instead will introduce two new chapters to the Main Board Listing Rules to allow the listing of (i) Biotech issuers² that are pre-revenue; and (ii) issuers from emerging and innovative sectors that have weighted voting right (WVR) structures, subject to additional disclosures and safeguards. The Exchange also proposes to modify the existing Main Board Listing Rules in relation to overseas companies to create a new secondary listing route to attract innovative issuers that have a primary listing on a Qualifying Exchange³.

Biotech issuers

The Biotech sector has been chosen as the initial focus on widening market access for early stage companies because the activities undertaken by Biotech companies tend to be strictly regulated under a regime that sets external milestones on development progress. This will provide investors with a frame of reference to judge the value of companies that do not have traditional indicators of performance (e.g. revenue and profit).

The Exchange proposes to facilitate the listing of Biotech companies that are pre-revenue through a new chapter in the Main Board Listing Rules, which will be supplemented with a guidance letter on the factors that the Exchange will take into account when determining an applicant's eligibility/suitability to list on a pre-revenue basis.

Biotech companies applying for a listing under this chapter must be primarily engaged in research and development (R&D), have unique features of innovation or intellectual property, and have at least one product that has proceeded beyond the concept stage. They will also be required to provide enhanced disclosures to ensure that investors are fully informed of the business and the R&D risks involved.

These Biotech issuers will need to have a minimum expected market capitalisation at the time of listing of at least HK\$1.5 billion. They would also be subject to the same regulatory standards as other applicants to the Main

¹ New Economy: Industries include biotechnology, healthcare technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware, storage peripherals

² Biotech issuers/companies: Companies engaged in the research and development, application and commercialisation of products, processes or technologies in the biotech sphere.

³ Qualifying Exchange: New York Stock Exchange (NYSE) and NASDAQ Stock Market or the Main Market of the London Stock Exchange (and belonging to the "Premium Listing" Segment of the UK Financial Conduct Authority (UK FCA))

Board, except for the financial track record requirements. Given the pre-revenue nature of eligible Biotech companies and the requirement to attract investment from at least one sophisticated investor, the Exchange proposes that shares held by cornerstone investors at the time of listing will not count towards determining whether the company has met the minimum initial public float requirement for listing to facilitate a market-driven book-building process and help ensure post-listing liquidity.

The Exchange will review the regime for listing pre-revenue companies to determine if other types of New Economy companies could also be permitted to list on a pre-revenue basis.

Issuers with a WVR structure

The Exchange proposes to facilitate the listing of high growth and innovative companies with a WVR structure through a new chapter in the Main Board Listing Rules. Applicants are limited to well-established companies with a minimum expected market capitalisation at the time of listing (Expected Market Cap) of at least HK\$10 billion. If an applicant with a WVR structure has an Expected Market Cap of less than HK\$40 billion, the Exchange will also require the applicant to have at least HK\$1 billion of revenue in its most recent audited financial year. Applicants will also be required to demonstrate that they are both eligible and suitable for listing with a WVR structure. In this regard, the Exchange will publish a guidance letter setting out the factors it will take into account when assessing whether such an applicant is eligible and suitable for listing. The Exchange would normally consider a company with WVR structures suitable for listing if they are able to demonstrate the following characteristics:

- The applicant must be an innovative company.
- The applicant has a track record of high business growth, and its high level of growth is expected to continue.
- Each WVR holder has an active executive role within the business and has been materially responsible for the growth of the business due to their skills, knowledge and/or strategic direction.
- Each WVR holder is or would assume the role of director of the issuer at the time of listing.
- The applicant has received meaningful third party funding from sophisticated investors.

Since companies with WVR structures potentially carry additional risks to investors, the following safeguards will be put in place:

- **Ring-fencing:** Only new applicants will be able to list with a WVR structure. After listing, issuers with WVR structures will be prohibited from increasing the proportion of WVR in issue or issue more WVR shares.
- **Eligible persons only:** Beneficiaries of WVR will be restricted to those who are directors of the issuer. The WVR attached to a beneficiary's shares will lapse permanently if he (i) ceases to be a director; (ii) dies or is incapacitated; or (iii) if the shares are transferred to another person.
- **Limits of WVR powers:** The rights (other than voting rights) attached to WVR shares and ordinary shares must be the same in all aspects. In addition, the Exchange will require certain key governance matters to be determined on a 'one-share, one-vote' basis.
- **Enhanced disclosures:** Issuers with WVR structures will be prominently identified through a unique stock code/marker. Appropriate warning language and a full description of the issuer's WVR structure, rationale and associated risks must be disclosed.
- **Enhanced corporate governance:** Issuers with a WVR structure are required to have a corporate governance committee consisting of INEDs. A compliance advisor is also required to be engaged on a permanent basis.
- **Constitutional backing:** The prescribed safeguards must be incorporated into the issuer's constitutional documents.
- **Anti-avoidance:** Anti-avoidance provisions will be added to the Main Board Listing Rules to prevent the circumvention of the prescribed WVR safeguards.
- **Enforcement:** A breach of the WVR safeguards to be built into the Main Board Listing Rules by WVR issuers will be enforced in the same way as any other listed issuer.

Secondary listings

The Exchange proposes to modify the existing Main Board Listing Rules in relation to overseas companies (and to also make consequential changes to the 2013 Joint Policy Statement). The amendments are to create a new secondary listing route to attract established issuers from emerging and innovative sectors that have a good record of compliance for at least two years on a Qualifying Exchange, and an expected market capitalisation of at least HK\$10 billion at the time of secondary listing in Hong Kong. A secondary listing applicant with (i) a WVR structure and/or (ii) a “centre of gravity” in the Greater China region will also be required to meet the revenue test applicable to WVR applicants, if it has an expected market capitalisation of less than HK\$40 billion at the time of secondary listing.

The current ban on companies with a “centre of gravity” in Greater China from conducting a secondary listing in Hong Kong (“Greater China Companies”) will be removed for companies from the emerging and innovative sectors.

Greater China Companies that have a primary listing on a Qualifying Exchange on or before the publication of the consultation conclusions, as well as Non-Greater China Companies, will not be required to amend their constitutional documents to demonstrate that they are subject to shareholder protection standards at least equivalent to those in Hong Kong. Instead, to safeguard the interests of minority shareholders, the Exchange will impose certain key shareholder protection standards⁴ as listing rule requirements.

Next steps

The Exchange is in the process of finalising the proposals and has begun drafting the proposed amendments to the Listing Rules to put them into effect. The Exchange intends to further refine the proposals through discussions with stakeholders, after which a formal consultation on the detailed proposals and proposed amendments to the Listing Rules will be conducted. The Exchange expects to begin the discussions shortly after the publication of the consultation conclusions, with a view to proceed with the formal consultation on the proposed rule amendments in the first quarter of 2018.



⁴ Key Shareholder Protection Standards are those set out in section 1 of the 2013 JPS, which comprise:

- (i) super-majority vote of members is required to approve fundamental matters (material changes to constitutional documents, variation of rights attached to any class of shares and voluntary winding-up);
- (ii) no alteration to the constitutional documents to increase an existing member's liability unless approved by the member;
- (iii) appointment, removal and the remuneration of auditors require the approval of a majority of shareholders or another body independent of the board of directors;
- (iv) issuers must hold an AGM at least every 15 months, give reasonable notice of meetings, and members should have the right to speak and vote at the shareholders' meeting;
- (v) minority shareholders must be allowed to convene an extraordinary general meeting (the level of members' support required to convene a meeting must not be higher than 10 percent); and
- (vi) the Hong Kong Securities Clearing Company Limited (HKSCC) must be able to appoint proxies.

Consultation conclusions on GEM reforms and changes to the GEM and Main Board Listing Rules

The majority of the proposals outlined in the consultation paper have been adopted, with the exception of the proposals on (i) track record period requirement prior to a GEM transfer and (ii) extending the post-IPO lock-up requirement on controlling shareholders of Main Board issuers.

Amendments to the Listing Rules will take effect from 15 February 2018, the Rule Amendment Effective Date.

The table below summarises the amendments to the GEM listing requirements:

	Current Regime	New Regime	Amendments to listing rules are adopted as proposed
Requirements for GEM transfers:			
Appointment of sponsor and preparation of prospectus standard listing document	Not required	Required	√
Admission requirements	Publish <u>one</u> full year's financial statements since listing + no investigations for serious breaches <u>12 months</u> before transfer	Publish <u>one</u> full year's financial statements since listing + no investigations for serious breaches <u>12 months</u> before transfer	x No change to current regime
GEM listings:			
Admission requirements:			
Minimum cashflow requirement	HK\$20 million	HK\$30 million	√
Minimum market capitalisation at the time of listing	HK\$100 million	HK\$150 million	√
Post-IPO lock-up period for controlling shareholders:			
- first lock-up period ⁽¹⁾	6 months	12 months	√
- second lock-up period ⁽²⁾	6 months	12 months	√
Open market requirements:			
Minimum public float	HK\$30 million	HK\$45 million	√
Offering mechanism	100% placing allowed	Mandatory public offering of at least 10% of total offer size ⁽³⁾	√
Placing to connected persons/connected clients	No restriction, provided full disclosure is made in the listing document	Align with Main Board where waiver/consent from the Exchange is required	√

Note:

- (1) The period starting from the date of listing, where controlling shareholder(s) cannot dispose any of their equity interest.
- (2) The period subsequent to the first lock-up period, where controlling shareholder(s) cannot dispose their equity interest to the extent that they lose their status as a controlling shareholder.
- (3) Main Board requirements on the allocation of offer shares between the public and placing tranches and clawback mechanism would apply.

The table below summarises the amendments to the Main Board listing requirements:

	Current Regime	New Regime	Amendments to listing rules are adopted as proposed
Main Board listings:			
Minimum market capitalisation at the time of listing	HK\$200 million	HK\$500 million	√
Minimum public float	HK\$50 million	HK\$125 million	√
Post-IPO lock up period for controlling shareholders:			
- first lock-up period	6 months	6 months	× No change to current regime
- second lock-up period	6 months	6 months	× No change to current regime

Transitional arrangements for Main Board and GEM listing applications and GEM transfers

Main Board and GEM listing applications

All Main Board and GEM listing applications will continue to be processed in accordance with the rules and requirements currently in force before **15 February 2018, the Rule Amendment Effective Date**. Any applications as at the Rule Amendment Effective date are only allowed one renewal of such applications thereafter.

New Main Board and GEM listing applications submitted after the Rule Amendment Effective Date will be processed under the **amended** Main Board Listing Rules and GEM Listing Rules, respectively.

GEM transfers

Before the Rule Amendment Effective Date

All GEM transfer applications that are submitted before the Rule Amendment Effective Date, and have not lapsed, been rejected or returned as at the Rule Amendment Effective Date, will continue to be processed under the GEM streamlined process. Any transfer applications as at the Rule Amendment Effective Date are only allowed one renewal of such applications thereafter.

Transitional period (three years from the Rule Amendment Effective Date)

A transitional period of three years from the Rule Amendment Effective Date will be given for Eligible Issuers⁵ to submit their transfer applications. During this period, the applicant's eligibility to transfer will be subject to the transitional arrangements as follows:

- For an applicant whose principal business **or** controlling shareholder(s) have **changed** since listing: The applicant is required to appoint a sponsor to conduct due diligence and publish a 'prospectus standard' listing document as if it is a new listing applicant to the Main Board.
- For an applicant whose principal business **and** controlling shareholder(s) have **not changed** since listing: The applicant is required to prepare a GEM transfer announcement, and to appoint a sponsor to conduct due diligence with respect to the applicant's activities during the most recent full financial year and up to date of the GEM transfer announcement.

⁵ Eligible Issuers: All issuers listed on the GEM and all GEM applicants who have submitted a valid listing application for listing on the GEM (and successfully listed on the GEM subsequently with only one refreshed application permitted) on or prior to 16 June 2017. Excludes infrastructure, mineral or investment companies to which any of the MB Listing Rules 8.05B(1) & (2), Ch.18 or 21 apply.

After the transitional period

All GEM transfer applications will be processed under the **amended** Main Board Listing Rules. Therefore, a sponsor is required to be appointed for all GEM transfer applications.

If you have any questions about the matters discussed in this publication, please feel free to contact the following partners in our Capital Markets Advisory Group.

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