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HKEX's consultation on listing regime for companies from emerging and innovative sectors

On 23 February 2018, the Hong Kong Stock Exchange (the Exchange) launched a formal consultation to seek public feedback on its proposal to introduce a new listing regime for companies from emerging and innovative sectors. This consultation follows the conclusions to the New Board Concept Paper published by the Exchange on 15 December 2017. The consultation period will end on 23 March 2018.

In the consultation paper, the Exchange proposes the introduction of three new chapters to the Main Board Listing Rules to allow the listing of:

- Biotech companies that do not meet any of the financial eligibility tests of the Main Board;
- High growth and innovative companies with weighted voting right (WVR) structures; and
- Qualifying Issuers[1] seeking a secondary listing on the Exchange.

BIOTECH COMPANIES

The Exchange proposes to add a new chapter – Chapter 18A – to the Main Board Listing Rules. This will be supplemented with guidance on the factors that the Exchange will take into account when determining the eligibility and suitability of listing an applicant that fails to meet any of the three financial eligibility tests under the existing Main Board Listing Rules (Chapter 8). Key features of the proposal are summarised below:

Qualifications and requirements:

Suitability – an applicant must be able to demonstrate the following features:

- *Product:* at least one Core Product[2] beyond the Concept Stage[3]
- *R&D:* primarily engaged in research and development (R&D) of its Core Product(s) for at least 12 months prior to listing
- *Purpose of IPO:* primary reason is to raise funding for R&D to bring its Core Product(s) to commercialisation
- *Intellectual property:* must have Core Product(s) with durable patent(s), registered patent(s), patent application(s) and/or relevant intellectual property
- *Sophisticated investor:* must have received meaningful third-party investment (more than just a token investment) from at least one sophisticated investor at least six months before the IPO, as well as at the time of the IPO

Market capitalisation – biotech companies will be required to have a minimum expected market capitalisation of HK$1.5 billion at the time of listing.

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1 A Qualifying Issuer is an issuer that has a primary listing on the New York Stock Exchange LLC (NYSE), Nasdaq Stock Market (Nasdaq) or the Main Market of the London Stock Exchange (LSE) (and belongs to the "Premium Listing" segment of the Financial Conduct Authority of the United Kingdom).

2 A biotech product that is required by applicable laws, rules or regulations to be evaluated and approved by a competent authority based on data derived from clinical trials (i.e. on human subjects) before it could be marketed and sold in the market regulated by that competent authority which forms the basis of a Biotech Company's listing application under Chapter 18A of the Main Board Listing Rules. Currently, the competent authorities recognised by the Exchange include the US Food and Drug Administration ("FDA"), the China Food and Drug Administration ("CFDA") and the European Medicines Agency ("EMA"), and may, at the discretion of the Exchange, recognise other national or supranational authorities in individual cases, subject to the consent of the SFC.

3 The proposal sets out specific guidance on the determination of whether the product has been developed beyond the concept stage for three products: 1) pharmaceuticals (small molecule drugs); 2) biologics; and 3) medical devices (including diagnostics). Other biotech products would be considered on a case-by-case basis.

Track record – the applicant must have operated in its current line of business for at least two financial years under substantially the same management.

Working capital – the applicant will be required to have available working capital to cover at least 125% of the costs (consisting primarily of general, administrative and operating costs and R&D costs) for at least the next 12 months after the initial listing (after taking into account the IPO proceeds).

Enhanced disclosure – the applicant will be required to make enhanced disclosures in the prospectus regarding the products and ongoing disclosures about R&D activities in interim and annual reports after listing.

Restriction on cornerstones – IPO shares subscribed by cornerstone investors and existing pre-IPO investors will not count towards the minimum initial public float requirement at listing or during the six month lock-up period.

Additional measures imposed by the Exchange to manage risks associated with biotech companies until they are able meet one of the financial eligibility tests:

- No fundamental change to the company's principal business except with the Exchange's consent;
- Failure to maintain sufficient operations or assets would be allowed a period of 12 months to ratify the issue. If the issue is not addressed after this period, the listing status would be subject to cancellation; and
- A biotech issuer will be identified through a stock marker "B" at the end of its stock name for differentiation.

ISSUERS WITH WVR STRUCTURES

The Exchange also proposes to introduce a new chapter – Chapter 8A – to the Main Board Listing Rules to allow the listing of innovative and high growth issuers that have WVR structures, subject to additional disclosures and safeguards. The listing of companies with WVR structures is restricted to new applicants only, and the issuer with the WVR structure will be prohibited from increasing the existing proportion of WVRs or issue more WVR shares after listing. Key features of the proposal are summarised below:

Qualifications and requirements:

Suitability – an applicant with a WVR structure would be regarded as suitable for listing if it can demonstrate the following characteristics:

- *Innovative:* the characteristics of an "innovative" company include: (1) its success is attributable to the application of new technologies, innovations and/or a new business model, or is attributable to its other unique features or intellectual property; (2) significance of R&D to the applicants' expected value; (3) an outsized market capitalisation or intangible asset value.
- *Successful track record:* a track record of high business growth, which is expected to continue
- *WVR beneficiary:* each WVR beneficiary must have an active executive role within the business and have contributed to the growth of the business; each WVR beneficiary must be a director at the time of listing
- *External validation:* the applicant must have received meaningful third-party investment (rather than just a token investment) from at least one sophisticated investor, and these investors must retain an aggregate 50% of their investment at the time of listing for a six month post-IPO period.

Market capitalisation – at least HK$10 billion at the time of listing.

Revenue – at least HK$1 billion in the most recent audited financial year if the expected market capitalisation at the time of listing is below HK$40 billion.

WVR beneficiaries – each WVR beneificiary must be an individual[4] and a director at the time of and after listing. At the time of listing, all beneficiaries of a WVR structured company must collectively beneficially own a minimum of 10% and a maximum of 50% of the underlying economic interest in the applicant's total issued share capital. The WVR attached to a beneficiary's shares will lapse permanently if he (i) dies or is incapacitated; (ii) ceases to be a director or no longer meet the requirements of a director; or (iii) if the shares or the attached voting rights are transferred to another person.

Additional ongoing safeguards for protecting shareholders of companies with WVR structures:

- ***Limits of WVR power*:** the voting power attached to the WVR shares is to be capped at 10 times the voting power of ordinary shares.

4 The Exchange will launch a separate consultation within three months from the implementation of these new Main Board Listing Rules to explore the option of allowing corporate entities to benefit from WVRs.

- ***Non-WVR shareholders' voting power:*** the WVR structure must enable non-WVR shareholders to cast at least 10% of the votes for resolutions at general meetings. In addition, the Exchange will also enable non-WVR shareholders holding at least 10% of the voting rights on a "one-share one-vote" basis to have the power to convene a general meeting and to add resolutions to the meeting agenda.
- ***Matters voted on a one-share one-vote basis:*** (1) changes to constitutional documents; (2) variation of rights attached to any class of shares; (3) appointment or removal of independent non-executive directors (INEDs) and auditors; and (4) voluntary winding-up.
- ***Enhanced disclosures*: **Issuers with WVR structures will be identified through a stock marker "W" at the end of its stock name for differentiation. These issuers will also be required to disclose warnings and a full description of the issuer's WVR structure, rationale and associated risks on the front page of their listing and post-listing documents.
- ***Enhanced corporate governance*: **Issuers with WVR structures will be required to establish a corporate governance committee, consisting of a majority of INEDs. The committee is to be chaired by an INED to ensure that the issuer is operated and managed for the benefit of all shareholders, and is in compliance with the Listing Rules. A compliance advisor is also required to be engaged on a permanent basis to provide advice to the issuers on compliance with WVR safeguards and the Listing Rules.
- ***Constitutional backing*: **the prescribed safeguards must be incorporated into the issuer's constitutional documents.

SECONDARY LISTING

The Exchange also proposed to add a new Chapter 19C to the Main Board Listing Rules and amend the 2013 SFC and Exchange's *Joint policy statement regarding the listing of overseas companies* (2013 JPS) to create a new concessionary route to a secondary listing for Qualifying Issuers. The qualifications and requirements for a secondary listing under this concessionary route are:

Eligibility and suitability – an applicant must be able to demonstrate that it is an innovative company by reference to "innovative" characteristics of issuers with WVR structures.

Record of compliance – the Qualifying Issuer must have a good record of compliance for at least two financial years on a Qualifying Exchange.[5]

Market capitalisation – the Qualifying Issuer must have an expected market capitalisation at the time of the secondary listing in Hong Kong of at least HK$10 billion.

Revenue – a secondary listing applicant with a WVR structure and/or is a Greater China Issuer must have revenue of at least HK$1 billion in the most recent audited financial year, if the expected market capitalisation is below HK$40 billion at the time of the secondary listing in Hong Kong.

Automatic waivers

It is proposed that the waivers in the Listing Rules – which are currently automatically granted by the Exchange to eligible listed companies seeking a secondary listing under the 2013 JPS – will be codified. These include requirements concerning connected transactions, notifiable transactions and the Corporate Governance Code.

Equivalence requirements

Greater China Companies that had a primary listing on a Qualifying Exchange on or before the date of publication of the New Board Concept Paper Conclusion on 15 December 2017 (Grandfathered Greater China Companies), as well as Non-Greater China Companies, will not be required to amend their constitutional documents for providing key shareholder protection standards set out in the 2013 JPS at least equivalent to those in Hong Kong as required for a secondary listing of overseas companies. This is as long as they are able to demonstrate to the Exchange's satisfaction, how the key shareholder protection standards are met by a combination of applicable domestic laws, rules and regulations, as well as its constitutional documents.

5 Qualifying Exchange: New York Stock Exchange LLC (NYSE), Nasdaq Stock Market (Nasdaq) or the Main Market of the London Stock Exchange (LSE) (and belonging to the "Premium Listing" segment of the Financial Conduct Authority of the United Kingdom.

VIE structures

The Exchange also proposed that Grandfathered Greater China Companies will be able to conduct secondary listings of their existing VIE structures. In this regard, the Exchange will require a PRC legal opinion that their VIE structures comply with PRC laws, rules and regulations. These issuers will also be required to meet the VIE guidance disclosure requirements.

WVR companies

Qualifying Issuers with a WVR structure seeking a secondary listing under the new concessionary route must satisfy the suitability and market capitalisation requirements referred to in the “Issuers with WVR Structures” section on Page 2. Grandfathered Greater China Companies and Non-Greater China Companies will not be required to comply with the proposed ongoing WVR safeguards, except for those that are disclosure requirements.

Non-Grandfathered Greater China Issuers

Non-Grandfathered Greater China Companies (i.e. Greater China Issuers that primary list on a Qualifying Exchange after 15 December 2017) will not be granted concessions for the equivalence requirements, VIE structures or WVR companies mentioned above.

Migration of the bulk of trading to Hong Kong

In the instance where the bulk of trading in the shares of a Greater China Issuer migrates to Hong Kong permanently, the Exchange proposes that the codified waivers granted to the issuer under the new concessionary route will no longer apply. These companies would be treated as having a dual-primary listing in Hong Kong, and on a case-by-case basis, would be granted waivers commonly granted to dual-primary listed issuers. However, Non-Greater China Issuers would be able to continue to enjoy automatic waivers granted under the new concessionary secondary listing route in the event that the bulk of trading migrates to Hong Kong.

Following a migration of the bulk of trading to Hong Kong, a Non-Greater China Issuer or a Grandfathered Greater China Issuer with a WVR structure will not need to comply with the Hong Kong WVR safeguards applicable to primary listings (other than WVR safeguards that are disclosure requirements).

Finally, Grandfathered Greater China Issuers will not be required to amend their VIE structures if the bulk of trading in their securities moves to the Exchange.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and director.

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