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Capital Market Law

Promoting New Economy - the HKEx took a leap

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On 15 December 2017, the Stock Exchange of Hong Kong Limited (the "**SEHK**") published its consultation conclusions on two consultations regarding the New Board and the Amendments to the Hong Kong Listing Rules (the "**GEM**") (collectively, the "**Consultation Conclusions**"). In brief, rather than establish a New Board, the SEHK proposes to expand Hong Kong's listing regime to allow "new economy" issuers with weighted voting right ('**WVR**') structures and pre-profit or pre-revenue biotech issuers, as well as create a new secondary listing route for overseas issuers. The SEHK further proposes to raise the minimum market capitalisation requirements for Main Board and GEM applicants, and cancel the GEM streamlined process. In avoidance of doubt, terms defined in the Consultation Conclusions shall have the same meaning when used in this newsletter unless otherwise defined.

A. "New Economy" Companies

The primary purpose of the proposed reform is to attract high-growth companies from innovative sectors (the "**New Economy Companies**").

New Economy Companies are expected to possess more than one of the following characteristics:

- its success is demonstrated to be attributable to the application of new technologies, innovations, and/or business model to the company's core business, which also serves to differentiate the company from existing players;
- research and development is significant contributor of expected value and constitutes a major activity and expense;
- its success is demonstrated to be attributable to unique features or intellectual property; and

- its market capitalisation or intangible asset value outsizes its tangible asset value.

The SEHK also proposes to publish guidance letters to provide the market with further guidance on the characteristics of New Economy Companies.

Hence, companies that fall short of certain characteristics above are unlikely be listed with a WVR structure or through the proposed secondary listing route.

B. WVR Structures

Applicants will be required to have an established business and establish that they are both eligible and suitable for listing with a WVR structure. After listing, they are also required to comply with the special requirements of the SEHK specifically for the WVR structure to protect investors' interests. Features of a company to be allowed to adopt a WVR structure are listed below:

Characteristics of a company suitable for listing with a WVR structure	*Business nature*	The applicant must be a New Economy Company as defined by the SEHK.
	Track record	The applicant demonstrates a track record of high business growth, which can be objectively measured by operational metrics such as business operations, users, customers, unit sales, revenue, profits and/or market value (as appropriate), and its high growth trajectory is expected to continue.
	Contribution of each WVR holder	Each WVR holder has been materially responsible for the business growth, by way of their skills, knowledge and/or strategic directions, where the company's value is largely attributable or attached to intangible human capital.
	Responsibility of each WVR holder	Each WVR holder has an active executive role within the business and contributes to a material extent to the ongoing business growth, and is or would assume the role of director of the issuer at the time of listing.
	External validation	The applicant has received meaningful (being more than just a token investment) third party funding from sophisticated investors (including financial institutions). Such investors will be required to retain an aggregate 50 percent of their investment at the time of listing for a period of at least six months post-IPO (subject to exceptions for de minimis investments by specific investors).
	Spin-off IPO	In the event that the applicant is a spin-off from a parent company, in order to assess the eligibility and suitability of a spin-off applicant to list with a WVR structure, the SEHK will assess such applicant on a stand-alone basis which is separate from the characteristics and track record of the parent (irrespective of whether the parent is listed on the Exchange or overseas).
Financial requirement	Expected market capitalisation is not less than HK$10 billion at the time of listing; and in the event that the expected market capitalisation of an applicant as described above is less than HK$40 billion, the SEHK will require such applicant to have at least HK$1 billion of revenue in its most recent audited financial year.	
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 weighted voting rights in issue or issue any further WVR share. It is subject to a limited right of pre-emption in the case of a pro rata offering to all shareholders (that is, a rights issue or open offer).	

Limits on beneficiaries of WVR	Beneficiaries of WVR will be restricted to those who are (and remain as) directors of the issuer. The WVR attached to a beneficiary's shares will lapse permanently: ➢ if the beneficiary ceases to be a director; ➢ if the beneficiary dies or is incapacitated; or ➢ if the shares are transferred to another person.
Limits on WVR powers	➢ the WVR structure must be attached to a specific class (or classes) of shares, and the rights attached to WVR shares and ordinary shares must be the same in all respects other than voting rights; ➢ the voting power attached to WVT cannot be more than ten times of that of ordinary shares, and non-WVR shareholders must hold at least 10% of the votes eligible to be cast at general meeting; moreover, non-WVR shareholders holding at least 10% of the voting rights on a one-share one vote basis must be able to convene a general meeting; and ➢ material changes to the issuer's constitutional documents, variation of rights attached to any class of shares, the appointment and removal of independent non-executive directors and auditors, and the winding-up of the issuers must be decided on a one-share one-vote basis.
Requirements regarding disclosure and corporate governance	➢ issuers with WVR structures must be prominently identified through a unique stock code/ market and appropriate warning in its ongoing corporate communications; ➢ the issuer must disclose in its listing documents appropriate warning language and a full description of its WVR structure, rationale and associated risks; ➢ the prescribed safeguards must be incorporated in the issuer's constitutional documents; ➢ a mandatory corporate governance committee comprised of independent non-executive directors is required to ensure that the issuer is operated and managed for the benefit of all shareholders, as well as the issuer's compliance with Hong Kong rules; and ➢ the issuer must engage a compliance adviser on a permanent basis; directors and senior management must undergo appropriate training on WVR and its associated risks.

C. Pre-Revenue Biotech Companies

In respect of pre-revenue New Economy Companies, the SEHK proposes to only allow biotech companies, which engaged in research and development, application and commercialisation of products, processes or technologies in the biotech sphere, to list through the new chapter in the Main Board Listing Rules. It is because biotech companies tend to be strictly regulated (such as by the Food and Drug Administration in the United States) as to the activities they undertake and are often required to meet the relevant regime's milestones on development progress. Therefore, even without traditional indicators of performance such as revenue and profit, investors are still provided with a frame of reference to assess the value of these companies.

In order to be listed on a pre-revenue basis, the SEHK required an applicant to demonstrate that it is a biotech company, which is normally expected to possess the following features:

- has been primarily engaged in research and development for the purposes of developing new or innovative products/processes/technologies;
- has unique features of innovation or intellectual property that could be reasonably expected to give rise to commercialisable patents, copyrights and/or trade secrets;
- has as its primary reason for listing the raising of finance for research and development to bring identified products/ processes/ technologies to commercialisation;
- has at least one product/ process/ technology which has proceeded beyond the concept stage (for example, having passed Phase I stage in relation to the clinical trial of a drug regulated by relevant drug and safety authorities such as the Food and Drug Administration in the United State, China Food and Drug Administration or European Medicines Agency and received all the necessary regulatory approvals to proceed to Phase II);
- has a portfolio of durable patents, registered patents and/or patent applications that demonstrates its rights to the new technologies or innovations that form the basis of its listing application; and
- has previously received investment from at least one sophisticated investor (including financial institutions).

Furthermore, the SEHK requires such biotech companies to have a minimum expected market capitalisation at the time of listing of not less than HK$1.5 billion, to maintain 125% of the current issuer's working capital requirement over the next 12 months, and have remained in operation in its current line of business (such as biotech research and development) for at least 2 years.

D. Secondary listings

a. Pursuant to the Joint Policy Statement Regarding the Listing of Overseas Companies jointly published by the Securities and Futures Commission and the SEHK 2013, a company seeking a secondary listing must:

i. be a large company, normally with a long track record of clean regulatory compliance on its primary market;

   - have been listed in its primary market for at least 5 years;
   - if the applicant seeking a secondary listing is well-established and has a market capitalisation that is significantly larger than USD 400 million, this track record criterion does not apply; and
   - demonstrate a good compliance record with the rules and regulations of its home jurisdiction and primary market;

ii. have a primary listing on one of the recognised exchanges; and

iii. have a centre of gravity outside Greater China.

(collectively hereinafter referred to as the "**JPS Requirements**")

Companies that fulfil the JPS Requirements will receive automatical waiver from certain provisions in the Main Board Listing Rules from shareholder protection standards, and accounting and auditing related and other disclosure requirements.

b. A company that intends to list through the new secondary listing route can be exempted from the "centre of gravity outside Greater China" requirement above if it possesses the following characteristics:

i. it is a New Economy Company as defined by the SEHK；

ii. it is primary listed on a Qualifying Exchange；

iii. it has a good record of compliance for at least two years on a Qualifying Exchange; and

iv. for a company with an expected market capitalisation at the time of secondary listing in Hong Kong of at least HK$10 billion, it will be required to have at least HK$1 billion of revenue in its most recent audited financial year if it:

   - has adopted a WVR structure; and/or
   - has a 'centre of gravity' in the Greater China region with an expected market capitalisation at the time of secondary listing in Hong Kong of less than HK$40 billion.

(collectively hereinafter referred to as the "**New Economy Companies Requirements**")

c. For the companies that have fulfilled the aforementioned JPS Requirements or New Economy Companies Requirements and other relevant exemptions, and are seeking secondary listing, the SEHK has proposed waivers specifically for different circumstances, as demonstrated below:

Is the centre of gravity of the company in Greater China?

Yes

Does the company meets the New Economy

Yes

Is the date of primary listing after 15 December 2017

Yes

Shareholder Protection Standard

- Where necessary, required to change its constitutional documents to meet equivalent shareholder protection standards to those of Hong Kong.

Exemptions to various WVR structures

- Must meet WVR safeguards and WVR structure must conform with primary listing requirements.

No

No

Does the company meets the JPS

Yes

Shareholder Protection Standard

a. Required to comply with the Key Shareholder Protection Standards set out in the Main Board Listing Rules.

b. Not required to comply with the following shareholder protection standards:

   - certain matters (material changes to the issuer's constitutional documents, a variation of class rights and winding-up) are subject to a 'super-majority' vote of shareholders;
   - no alteration is made to the constitutional documents to increase an existing member's liability unless approved by such member;
   - the appointment, removal and the remuneration of auditors requires the approval of a majority of shareholders or other body independent of the board
   - issuer must hold an AGM at least every 15 months, give reasonable notice of meetings and members to have the right to speak and vote at the shareholders' meeting;
   - minority shareholders must be allowed to convene an extraordinary general meeting (and minimum level of members' support required to convene a meeting must not be higher than 10%); and
   - The Hong Kong Securities Clearing Company Limited must be entitled to appoint proxies to attend meetings of directors.

Exemptions to various WVR structures

- Can secondary list with their existing WVR structures and will not have to comply with the proposed ongoing WVR safeguards except for disclosure requirements regarding listing documents, stock code/ marker and corporate communications.

E. Raising the admission requirement of the Main Board and the GEM

a. for GEM applicants, the minimum market capitalisation requirement is proposed to increase from HK$100 million to HK$150 million, while the minimum public float value of securities is proposed to increase from HK$30 million to HK$45 million;

b. for Main Board applicants, the minimum market capitalisation and public float value of securities requirements are increased from HK$200 million to HK$500 million and from HK$50 million to HK$125 million respectively;

c. the cashflow requirement for GEM applicants is also increased from at least HK$20 million to at least HK$30 million;

d. a mandatory public offering mechanism of at least 10% of the total offer size will be introduced for all GEM IPOs; and

e. the post-IPO lock-up requirement on controlling shareholders for GEM issuers will be extended from one year to two years, while that for Main Board issuers will remain unchanged.

F. Cancellation of the GEM Streamlined Process

a. Background

The GEM was repositioned as a "stepping stone" to the Main Board in 2008 to provide a channel for smaller companies that had grown and developed in size and maturity while on GEM to list more easily on the Main Board. However, such arrangement had achieved limited success. Further, an issuer can list on the Main Board without having gone through the due diligence process through GEM Streamlined Process. Due to the different eligibility criteria between the two boards, there is a risk of regulatory arbitrage. Hence, the SEHK will reposition the GEM as a stand-alone board and requires applicants applying for transfer that do not fall under the transitional arrangements to appoint a sponsor to conduct due diligence and publish a listing document to list on the Main Board.

b. Comparison between the original and new arrangements:

	Prior to 15 February 2018	**15 February 2018 and after**
GEM listing applicants	GEM listing or transfer applications submitted before and have not lapsed, been rejected or returned as at 15 February 2018 (any such application can only be renewed once after 15 February 2017) will be processed under the GEM Listing Rules in force as at 15 February 2018.	Applications will be processed under the amended GEM Listing Rules and any subsequent GEM transfer applications will be processed under the amended Main Board Listing Rules.

Main Board listing applicants	GEM listing or transfer applications submitted before and have not lapsed, been rejected or returned as at 15 February 2018 (any such application can only be renewed once after 15 February 2017) will be processed under the Main Board Listing Rules in force as at 15 February 2018.	Applications will be processed under the amended Main Board Listing Rules.

G. Other matters

a. Name change

To reflect the new role of GEM as a market for small and mid-sized enterprises, the names "Growth Enterprise Market" and "創業板" will be changed to "GEM".

b. Unwinding the delegated authority

The authority to approve GEM listing applications will be transfer from the Listing Division to the Listing Committee.

Important Announcement

This article has been prepared by Miao & Co. in association with Han Kun Law Offices. It is for general reference purposes only and should not be relied on as legal advice or regarded as a substitute for detailed advice in individual cases.

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