



## RESPONSE TO CONSULTATION PAPER ON CORPORATE WVR BENEFICIARIES

We refer to the Consultation Paper on Corporate WVR Beneficiaries (**Consultation Paper**) issued in January 2020. Please see below our responses to each of the questions, adopting the numbering in the Questionnaire on Corporate WVR Beneficiaries that accompanied the Consultation Paper.

Unless otherwise defined, all capitalised terms used in the response shall have the same meaning as defined in the Consultation Paper.

### Question 1

We support the Exchange's initiative to permit corporate entities to benefit from WVRs. We believe this is necessary to maintain the competitiveness of the Hong Kong market and enable the Exchange to attract listings by companies in fast growing sectors. We note the observations in the Consultation Paper that the Hong Kong market faces the challenges of a lack of diversity and high sector concentration and has been unable to accommodate the listing of well-known Mainland internet companies due to their shareholding structures. We consider that the additional risks associated with corporate WVRs can be managed by safeguards in the Listing Rules as outlined in the Consultation Paper and enhanced disclosure.

### Question 2

We agree with the proposal to only permit Eligible Entities or their wholly-owned subsidiaries to hold WVRs. As mentioned in the Consultation Paper, this will provide some limited structuring flexibility to the corporate shareholder to enable holding via a special purpose vehicle, subject to the proposed safeguard that only the Eligible Entity is entitled to direct the voting of the WVR shares. This safeguard preserves the nexus with the Eligible Entity and its management and board. We also agree with the concerns noted in the Consultation Paper that if the WVRs were to be required to fall away on a change of control of the corporate WVR beneficiary, this would amount to a poison pill.

### Question 3(a)

We note the studies referenced in the Consultation Paper arguing that controlling shareholders may have less of a disincentive to extract benefits from a company for themselves at the expense of other shareholders as their economic interest in the company falls. We therefore agree with the adoption of a requirement that the corporate WVR beneficiary have a sufficient economic interest in the WVR issuer such that WVRs would only apply where the corporate shareholder would have a large degree of effective control in any event. While the threshold for individual WVR beneficiaries, collectively, is 10% of the underlying economic value in the applicant's total issued share capital at the time of listing, we agree with the rationale stated in the Consultation Paper that WVRs should only be available to corporate beneficiaries at a higher threshold and we agree that the proposed 30% shareholding is a sensible approach. This aligns with the definitions of control in both the Takeovers Code and Listing Rules. We also note the Exchange's reasoning in the Consultation Paper that setting the level at 30% and requiring the corporate WVR beneficiary to be the single largest shareholder (save for any individual WVR beneficiary) will have less of a practical impact on the rights of other shareholders. We also note the empirical evidence from the US market quoted in the Consultation Paper that shows that, of the companies reviewed, on average the non-fund corporate holdings represented a 38% stake at listing.

As a result, we consider that the approach to require a corporate WVR beneficiary to hold at least a 30% economic interest in the WVR issuer and requiring it to be the single largest shareholder (save for any individual WVR beneficiary) is sensible. Whilst this is not a requirement of US stock

exchanges, it provides an additional safeguard for Hong Kong investors that corporate WVR beneficiaries would be limited to those companies that would be controlling shareholders under the Listing Rules and Takeovers Code. WVRs should be limited to those eligible companies that have a substantial economic interest in the WVR issuer.

#### **Question 3(b)**

We agree that the WVRs attached to a corporate WVR beneficiary's shares should lapse if it fails to maintain at least a 30% economic interest, or such other minimum threshold as is set. As mentioned in question 3(a) above, we consider it important that the corporate beneficiary has a substantial economic interest in the WVR issuer to justify the WVRs. Where the shareholding falls below the threshold, this would indicate a potential decrease in the commitment to the WVR issuer such that the benefit of the WVRs should no longer apply.

#### **Question 4(a)**

Please see our response to Q 3(a).

#### **Question 4(b)**

We do not believe that any other conditions or requirements should apply if a lower economic interest is allowed, provided that the regime contains the proposed requirements for the corporate WVR beneficiary to maintain its intangible contribution to the WVR issuer and the other ongoing ring-fencing measures as set out in the Consultation Paper.

#### **Question 5**

If the WVRs will lapse if the corporate WVR beneficiary's economic interest falls below 30%, we agree that the corporate WVR beneficiary should be given the opportunity to subscribe for additional shares in order to maintain its WVRs.

We note from paragraph 144 of the Consultation Paper that the proposed waiver from the shareholder approval requirement for a non-pre-emptive share issue would only enable the corporate WVR beneficiary to maintain its percentage economic interest at the 30% level and would not apply to enable the WVR beneficiary to maintain the percentage economic interest held prior to the relevant event leading to the dilution (to the extent that this is more than 30%). We agree with this approach which limits the dispensation given to the corporate WVR beneficiary to only that required to prevent the WVRs from lapsing and not to provide an absolute non-dilution right.

We would invite the Exchange to clarify how the top-up right is expected to operate from a practical perspective and from a company law perspective. For instance, is it envisaged that the top-up shares would be issued under the general mandate (in which case there would need to be a further exemption from the restriction on issuing shares under the general mandate to connected persons as set out in Note 1 to Listing Rule 13.36(2)(b))? Alternatively, would the WVR issuer need to obtain shareholder approval by way of a separate mandate catering for the top up which would be in addition to its general mandate? Further, we would invite the Exchange to clarify how shareholders' approval for the top up would be viewed by the Exchange under Rules 2.15 to 2.17 of the Listing Rules. In particular, would the corporate WVR beneficiary be regarded as having a material interest in the underlying placement transaction which triggers the top-up right as a result of itself benefiting from the relevant top-up right, rendering the underlying placement transaction subject to independent shareholders' approval?

In addition, the current proposal does not fully address the price that the corporate WVR beneficiary would need to pay where, for instance, share options are exercised or where shares are issued for non-cash consideration. We note that paragraph 144(d) of the Consultation Paper requires that the subscription price paid is fair and reasonable (having regard, among other things, to the average trading price of the listed issuer's stock over the preceding three months). We do

not believe that this requirement is sufficiently precise and it will be open to interpretation. We invite the Exchange to consider whether there should be a floor set in the Listing Rules by reference to a maximum discount from a referenced set of share prices (for example the prior day closing price, five day trading average and the average price over the past three months) that the shares should be subscribed for by the corporate WVR beneficiary.

#### **Question 6**

We agree with the proposal to require corporate WVR beneficiaries to have held an economic interest of at least 10% and to have been materially involved in the management of the WVR listing applicant for at least two financial years prior to the listing date. We agree with the Exchange's view that this would be sufficient to demonstrate its economic and management commitment to the WVR listing applicant.

We note that paragraphs 148 and 149 of the Consultation Paper appear to conflict with one another. It would be helpful if the Exchange could clarify the ownership expectations to be held throughout the two financial years given paragraph 149 of the Consultation Paper suggests that an increase shortly before listing may impact suitability. Paragraph 148, by contrast, suggests that an increase from 10% to 30% as a pre-IPO investment or as a placing to an existing shareholder in compliance with the guidance would be permitted.

#### **Question 7(a)**

We agree with the Exchange's proposal that the maximum ratio of weighted votes permitted for shares of a corporate WVR beneficiary should be lower than that permitted for individual WVR beneficiaries and should be set a no more than five times the voting power of ordinary shares.

We agree with the Exchange's rationale as set out in the Consultation Paper that this will cap the control that a corporate WVR beneficiary will have and will help to limit any misalignment of interests.

We note that currently the Listing Rules require that Non-WVR shareholders must be entitled to cast at least 10% of the votes that are eligible to be cast on resolutions at general meetings. We assume that this concept will be retained under a regime that permits both individual and corporate WVR beneficiaries.

#### **Question 7(b)**

See response to 7(a).

#### **Question 8**

Yes, we agree with the Exchange's proposal to require a corporate WRV beneficiary to demonstrate its contribution through the inclusion of the WVR listing applicant in its ecosystem. We agree with the rationale set out by the Exchange in the Consultation Paper. This proposal ensures that the contribution made by the corporate WRV beneficiary is meaningful beyond financial investment and is sufficiently integral to the success and future growth of the WVR issuer. We agree that the contribution of mere know-how or strategic advice should not be considered as a suitable trigger to enable a corporate investor to benefit from WVRs.

#### **Question 9**

We agree with the Exchange's suggested characteristics of an ecosystem as set out in paragraph 156 of the Consultation Paper.

### **Question 10**

We do not have any additional suggestions as to other circumstances that could justify the granting of WVRs to a corporate WVR beneficiary or should be required as a pre-requisite to WVRs being granted.

### **Question 11**

We agree that WVRs should be available to a corporate WVR beneficiary where the issuer is a traditional economy company where it is able to satisfy the eligibility criteria and has developed the required ecosystem. The principles should apply to companies irrespective of their industry where they are able to show the necessary essential co-existence characteristics and synergistic benefits and ongoing commitment to the development of the issuer. This may additionally help boost innovation, growth and development in traditional economy sectors.

### **Question 12**

We support the proposal that the corporate WVR beneficiary should continue to provide a contribution to the WVR issuer on an ongoing basis. Individual WVR beneficiaries need to demonstrate that they were materially responsible for the growth of the business as a result of their skills, knowledge or strategic direction. That individual must have an active executive role within the business. The WVRs lapse if that individual ceases to be a director or is no longer deemed to meet the requirements of a director. This shows an expectation that the pre-listing contribution would need to be sustained in order to continue to benefit from WVRs. In the same way, we would expect the pre-listing commitment and contribution of a corporate WVR beneficiary to be maintained in order to justify the privilege of the enhanced voting rights.

We note that the proposal is that the WVRs would fall away if the corporate's contribution to the WVR issuer is substantially terminated or materially disrupted or suspended for a period exceeding 12 months. We invite the Exchange to consider whether the timeframe threshold for the lapse of the WVRs should be a fixed 12 month period or should be more flexible and looked at in terms of the circumstances leading to the termination, disruption or suspension. It may be that a different test should be applied depending on the circumstances surrounding the change in the corporate's contribution (for example where the relevant corporate contribution has been substantially terminated).

### **Question 13**

Please see the response to question 12 above.

### **Question 14(a)**

We agree with the proposal that the Corporate Governance Committee should have a role in monitoring the ongoing commitment of the corporate WVR beneficiary to the WVR issuer and should give a confirmation every six months that there are no grounds for the WVRs to lapse. We consider that, whilst the remit of the Corporate Governance Committee should be set out in the terms of reference, the requirement to provide the confirmation should be a Listing Rule requirement. We suggest that the confirmation by the Corporate Governance Committee should be included in the interim and annual report of the WVR issuer.

In order to facilitate the work of the Corporate Governance Committee, the corporate WVR beneficiary should be required to give an undertaking to the Company and the Exchange that it will allow the Corporate Governance Committee sufficient access to its records as are required to enable the Corporate Governance Committee to assess the ongoing ecosystem and continued contribution to the WVR issuer. This would be similar to the requirement in Rule 14A.58 which requires listed issuers to ensure that connected persons provide sufficient access to auditors, which is achieved by a confirmation from the connected person at the time of listing.

**Question 14(b)**

Please see response to question 14(a).

**Question 15**

We agree with the Exchange that there should be a minimum market capitalisation requirement of HK\$200 billion to qualify to be a corporate WVR beneficiary. This will ensure that those seeking to list with corporate WVR beneficiaries are linked with and benefit from the support of leading and substantive companies that can bring significant benefits to the WVR issuer.

**Question 16**

In our view, the market capitalisation should be a bright line test as proposed in the Consultation Paper. Any exception should be confined to very exceptional circumstances such as failure to meet the threshold solely as the result of extreme market volatility.

**Question 17**

We agree that the corporate WVR beneficiary must be either an Innovative Company or have business experience in one or more emerging and innovative sectors, together with a track record of investments in, and contributions to, innovative companies. We consider the innovative nature of both the WVR issuer and the corporate WVR beneficiary to be critical to being able to justify the WVRs as an exception to the "one share one vote" principle.

**Question 18**

We agree that the corporate WVR beneficiary must be, and remain, a listed company on the Exchange or a Qualified Exchange. As noted by the Exchange, this will ensure a greater level of regulatory oversight which gives greater comfort to Hong Kong investors.

**Question 19**

We agree that the listing applicant must not represent more than 30% of the corporate WVR beneficiary in terms of market capitalisation at the time of listing. We agree with the Exchange's view in the Consultation Paper that this will help ensure that existing issuers cannot introduce WVRs over material parts of their business.

**Question 20(a)**

We agree with the proposed requirement that at least one director of the listing application must be a Corporate Representative (namely an officer of the corporate WVR beneficiary). This will ensure that the corporate WVR beneficiary has a degree of fiduciary duties in relation to the management of the WVR issuer through a member of its board also being a board member of the WVR issuer.

**Question 20(b)**

We do not have any additional suggestions.

**Question 21**

We generally agree with the proposal that the WVRs attached to a corporate WVR beneficiary's shares should lapse in the circumstances set out in the Consultation Paper.

We consider that 30 days absence of a Corporate Representative may be too short a period of time to trigger the lapse of the WVRs. Given the corporate WVR beneficiary is a company, it may have more than one key director on its own board who is integral to the ongoing investment of the corporate WVR beneficiary in the WVR issuer. If the person who is appointed as the Corporate

Representative were to cease to be employed by the corporate WVR beneficiary or to become unable to fulfil the role of the Corporate Representative or be a director of the corporate WVR beneficiary for any reason, it may still be appropriate and acceptable for the corporate WVR beneficiary to appoint another officer as the Corporate Representative and director of the WVR issuer. The process of appointing a new director to the board of the corporate WVR beneficiary may take more time (and may indeed need to be approved by the shareholders, particularly where the corporate WVR beneficiary does not have a majority vote). The regime should cater for this.

#### **Question 22**

We agree with the proposal that there be a time-defined sunset on the WVRs of a corporate WVR beneficiary. This ensures that the rights will fall away (as they would for a natural person upon their death).

#### **Question 23 – assuming agree with sunset period is Q22**

Yes, we agree with the proposed maximum 10 year length for the initial “sunset period”.

#### **Question 24(a)**

We agree that the WVRs of a corporate WVR beneficiary could be renewed at the end of the sunset period with the approval of independent shareholders. This will give flexibility to shareholders to be able to extend the WVRs where there is ongoing strategic commitment by the corporate WVR beneficiary. This approach also gives shareholders the opportunity to vote against the continued WVRs if they feel that this would be appropriate in the circumstances.

We consider there is a risk that shareholders may find it difficult to make a genuine decision on whether or not to renew the WVRs. We would invite the Exchange to consider and provide guidance on the procedural requirements to be followed and information that should be provided to independent shareholders to enable them to make an informed decision. For instance, we assume that an independent financial adviser will be required in accordance with Rule 13.39(6) of the Listing Rules.

#### **Question 24(b)**

We agree with the maximum five year length for incremental shareholders’ approved extensions to the sunset period. This period balances the need to not overly extend the timeframe for the sunset but ensures that a further meaningful time is added to the WVRs as part of the corporate WVR beneficiary’s ongoing strategic commitment to the WVR issuer.

#### **Question 25**

We agree that there should be no limits on the number of times that the WVRs of a corporate WVR beneficiary can be renewed. This should be left for shareholders to consider at the time and should not have an ultimate back stop date.

#### **Question 26**

We do not have any suggestions as to any other requirements to be imposed on a corporate WVR beneficiary as a condition to renewing its WVRs.

#### **Question 27**

We agree in principle that the Exchange should not restrict an issuer from being able to grant WVRs to both individual and corporate WVR beneficiaries where each is able to meet the suitability requirements and the circumstances merit it. This recognises that the strategic contributions could come from either an individual or a corporate, which we believe could be the case.

### **Question 28**

We do not have any additional measures to propose to safeguard the interests of the WVR issuer if there are both individual and corporate WVR beneficiaries. The Listing Rules do not impose any measures to address deadlock in companies without WVRs where there could be a deadlock situation when there are two controlling shareholders or significant shareholding blocks with different views on how the business should be operated. Similarly, the Listing Rules do not impose any measures to resolve deadlock if there is more than one individual WVR beneficiary. The risk of deadlock should be dealt with through disclosure and left to be resolved as a commercial matter and by the operation of market forces.

### **Question 29**

We agree that where the WVR issuer has both a corporate WVR beneficiary and an individual WVR beneficiary, the sunset clause should only apply to the corporate WVR beneficiary. We agree with the Exchange's view in the Consultation Paper that an individual WVR beneficiary is already subject to an event based sunset.

We assume that the same analysis will be applied in the context of the lapse of WVRs held by another corporate WVR beneficiary.

We note that in the Consultation Conclusions on the listing regime for companies from emerging and innovative sections published by the Exchange in April 2018, the SFC clarified (in the context of the lapse of an individual WVR beneficiary's WVRs) that a mandatory general offer would not normally be required if a relevant person is independent of the event which has led to the WVRs falling away. We would invite the Exchange to seek further guidance from the SFC as to whether the same analysis will be applied in the context of the lapse of WVRs held by a corporate WVR beneficiary.

### **Question 30**

Yes, we agree that in the event that the WVRs of the corporate WVR beneficiary fall away as part of the time-defined sunset, the individual WVR beneficiary should be required to convert part of their WVRs shares into ordinary shares such that the individual's proportional voting power is the same after the corporate WVR beneficiary's WVRs fall away. This will ensure that the individual WVR beneficiary does not increase their control as compared to the ordinary shareholders merely by virtue of the lapse of the WVRs attaching to the corporate WVR beneficiary.

We note that the Consultation Paper only proposes that this applies in respect of the lapse of the WVRs as a result of the time-defined sunset. However, we consider that this could also be appropriate where the corporate WVR beneficiary's WVRs fall away for other reasons. We note that this protection is not included where there are multiple individual WVR holders. However, given that corporate WVR beneficiaries are required to hold at least 30% of the economic interest in the WVR issuer under the current proposals, the impact on an individual WVR beneficiaries control relative to the ordinary shareholders will be significant unless similar measures are introduced to cover this scenario.

### **Question 31**

We believe that the same rules should apply to both individual and corporate WVR beneficiaries with regards to the need to convert WVR shares to ordinary shares upon the lapse of WVRs. This will prevent one category of WVR beneficiary from benefiting disproportionately when the WVRs of the other lapses and will ensure fair treatment for the ordinary shareholders (who benefit proportionately less).

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