HKEX
香港交易所

15 December 2017

FAQ on New Board Concept Paper Consultation Conclusions

1. Why is it necessary to expand the existing listing regime to facilitate the listing of issuers from the emerging and innovative sectors?

It is necessary to expand the existing listing regime to ensure the Hong Kong stock market will remain relevant and competitive in the future amid a changing global capital markets environment. A holistic review of Hong Kong's listing regime undertaken by the Exchange identified high concentrations within our market, particularly in old economy sectors, and a need to attract more issuers from emerging and innovative sectors.

Specifically, our current listing regime restricts such issuers within the following categories:

a) Pre-revenue/Pre-profit companies;
b) Companies with non-standard governance features; and
c) Mainland Chinese companies that wish to have a secondary listing in Hong Kong.

The Concept Paper was published to solicit market feedback on whether or not it was necessary to expand the current regime to provide access to a more diverse range of companies, so as to better serve the needs of investors and a wider range of issuers, and, if so, the most appropriate way of doing so.

The Exchange received broad support from respondents to take measures to broaden capital markets access in Hong Kong and enhance its competitiveness as a global financial centre.

2. What is the definition of a New Economy company?

The intention of the proposals in the Concept Paper was to attract more high growth companies from emerging and innovative sectors, or so-called New Economy companies. However, as acknowledged in the Concept Paper, it is hard to define such companies, since they encompass a range of sectors and are not necessarily restricted to specific sectors. The definition is also likely to evolve over time. The Exchange will therefore publish a guidance letter on the characteristics of innovative companies to the market. At present, the Exchange considers an innovative company would normally be expected to have more than one of the following characteristics:

a) its success is demonstrated to be attributable to the application of new (1) technologies; (2) innovations; and/or (3) business model to the company's core business, which also serves to differentiate the company from existing players;
b) research and development (R&D) is a significant contributor of expected value and constitutes a major activity and expense;
c) its success is demonstrated to be attributable to unique features or intellectual property; and
d) it has an outsized market capitalisation / intangible asset value relative to its tangible asset value.

In relation to pre-revenue New Economy companies, the Exchange proposes to initially limit these to applicants to biotech companies. The reasons are set out below. As the Exchange gains more experience in listing companies from emerging and innovative sectors, we will look to update the guidance as appropriate.

3. Why has the Exchange decided to introduce two new chapters to the Main Board Listing Rules to allow the listing of emerging and innovative companies, rather than creating a New Board as originally proposed?

We share the market's view that new chapters to the current Rules are the best approach because one premium board is better than two, there is no segmenting and there is no exclusion of retail investors. We see the outcome from the Concept Paper as a very good outcome for everyone from issuers and intermediaries to retail investors.

The Concept Paper originally proposed to set up a new board with two segments, largely reflecting the Exchange's concerns that the introduction of several big changes into the Main Board might be too difficult and controversial to generate a workable consensus to move forward in a timely manner. Like many Chinese-style reforms, experimenting with new concepts in a separate "pilot" programme is considered easier and more likely to be accepted quickly. We are therefore pleased that the respondents have all demanded a simpler and less segmented structure and that our key stakeholders also favour this direction, which is why we propose new chapters on the Main Board instead of new boards.

4. On accepting pre-revenue companies, why has the Exchange initially focused on Biotech companies? Why do they deserve special arrangements?

Respondents were highly supportive of permitting pre-profit companies to list in Hong Kong, acknowledging that many businesses involved in R&D-intensive sectors have legitimate capital markets needs ahead of having a revenue-generating commercial product or service.

HKEX
香港交易所

As companies at the pre-revenue stage potentially carry additional risks, the Exchange proposes to initially limit applicants permitted to list on a pre-revenue basis to Biotech companies. In practice, Biotech companies make up a majority of pre-revenue listings. Further, the activities of companies in the Biotech sector, which is heavily geared towards R&D, tends 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).

Such issuers would also be required to provide enhanced disclosures to ensure that investors are fully informed of the business and the risks involved.

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

5. What are the companies in the Biotech industry that you hope to attract? What would be the criteria and conditions for the listing of these companies?

The Biotech industry represents companies engaged in the research and development, application and commercialisation of products, processes or technologies in the biotech sphere. For illustrative purposes, this will include companies in pharmaceuticals, biotechnology & life sciences; healthcare equipment & supplies; and healthcare technology.

The Exchange has proposed to permit Biotech companies that have a minimum expected market capitalisation at the time of listing of at least $1.5 billion to list under the new chapter.

Applicants must have at least one product which has proceeded beyond the concept stage (for example, having passed Phase I in relation to the clinical trial of a drug regulated by relevant drug and safety authorities such as the FDA (US), CFDA (China) or EMA (Europe) and have received the necessary regulatory approvals to proceed to Phase II).

The higher minimum expected market capitalisation requirement will limit applicants to the relatively more established businesses. Biotech companies applying for a listing under this new chapter will be required to provide enhanced disclosures to ensure that investors are fully informed of the business and R&D risks involved.

HKEX
香港交易所

6. **What companies will be allowed to list with WVR structures?**

The Exchange proposes to facilitate the listing of innovative companies with a WVR structure through a new chapter in the Main Board Listing Rules (a consequential modification will be made to Rule 8.11 of the Main Board Listing Rules to create an exception to the general restriction against WVR).

Applicants will be required to establish that they are both eligible and suitable for listing with a WVR structure. The Exchange will publish a guidance letter outlining the factors that will be taken into account when assessing whether such an applicant is eligible and suitable for listing.

The applicant will be required to meet the "innovative company" definition and justify the rationale for founders and key executives of the company having weighted voting rights due to their previous contributions to the development of the company and their importance to its future growth. The Exchange will also reserve the right to reject an applicant on suitability grounds if its WVR structure is an extreme case of non-conformance with governance norms (for example, if the ordinary shares carry no voting rights at all).

The Exchange also proposes to initially limit applicants permitted to list with WVR structures to those companies that have a minimum expected market capitalisation at the time of listing of at least $10 billion. If an applicant with a WVR structure has an expected market capitalisation at listing of less than $40 billion, the Exchange will also require the applicant to have at least $1 billion of revenue in its most recent audited financial year.

These thresholds will limit applicants to more established and high-profile companies that are already subject to some degree of public scrutiny. It will also help ensure that a small economic interest in the company held by a WVR holder will be large enough, in dollar terms, to align their interests with those of other shareholders.

7. **What are the conditions and safeguards the Exchange has in mind for accepting companies with WVR structures?**

Companies with WVR structures potentially carry additional risks to investors. Accordingly, the Exchange requires that issuers with WVR structures must put in place certain safeguards, as set out below.

HKEX 香港交易所

Ring-fencing

a) Only new applicants will be able to list with a WVR structure. The Exchange will put in place a general anti-avoidance rule to protect shareholders from companies attempting to use artificial means to circumvent this restriction; and

b) after listing, issuers with WVR structures will also be prohibited from increasing the proportion of WVRs in issue.

Eligible persons only

a) Beneficiaries of WVRs will be restricted to those who are (and remain as) directors of the issuer. The WVR attached to beneficiaries' shares will lapse permanently if they cease to be a director, die or become incapacitated or if the shares are transferred to another person. This is to ensure that only persons whose benefit from WVRs is justifiable and who owe fiduciary duties to the issuer would be able to be able to have them; and

b) the Exchange would require beneficiaries of WVRs to meet a minimum equity threshold at IPO to help ensure that their interests are commercially aligned with the shareholders of the issuer.

Limits on WVR powers

a) The Exchange would require the WVR structure to be attached to a specific class (or classes) of shares;

b) to mitigate expropriation and entrenchment risks, the Exchange would require that the voting power of shares with WVRs to be capped to not more than ten times that of ordinary shares, and that non-WVR shareholders must hold at least 10 per cent of the votes eligible to be cast at general meeting. The Exchange will also require that non-WVR shareholders holding at least 10 per cent of the voting rights on a one-share one-vote basis must be able to convene a general meeting; and

c) the Exchange will require the following key matters to be decided on a one-share one-vote basis: 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; the appointment and removal of auditors; and the winding-up of the issuer.

Enhanced disclosure

a) The Exchange will require issuers with WVR structures to be prominently identified through a unique stock code/marker and appropriate warnings to be included in the issuer's ongoing corporate communications; and

b) the Exchange will require appropriate warning language and a full description of the issuer's WVR structure, rationale and associated risks to be disclosed in its listing documents.

Enhanced corporate governance

a) The Exchange would require a mandatory corporate governance committee comprised of independent non-executive directors (INEDs) to ensure that the issuer is operated and managed for the benefit of all shareholders and to help ensure the issuer's compliance with Hong Kong rules (including the safeguards); and

b) the Exchange would also require that the issuer engage a compliance adviser on a permanent basis and require directors and senior management to undergo appropriate training on WVR and its associated risks.

Constitutional backing

a) The Exchange will require the prescribed safeguards to be incorporated in the issuer's constitutional documents; and

b) this requirement is intended to allow private legal actions to be taken for breaches of the safeguards.

8. Why have you not included a sunset clause in the proposed WVR safeguards?

The Exchange has not proposed sunset clauses but has suggested imposing restrictions on the holders of WVR which effectively set a time limit like a sunset clause.

The Exchange has reviewed the responses and considered that a time-defined sunset clause would likely make the Hong Kong regime very uncompetitive versus overseas markets where no such requirement exists (particularly the US). However, the Exchange has included a restriction on the WVR beneficiary's ability to transfer the weighted voting rights attached to their shares. Further, a beneficiary's WVRs will fall away if he/she ceases to be a director, dies or becomes incapacitated. The practical effect of these requirements is that WVRs will not exist indefinitely for companies listed in Hong Kong. Therefore we

HKEX
香港交易所

believe in practice we have addressed the suggestion from some of the respondents for the inclusion of a sunset provision.

9. You propose to implement a lot of new requirements, particularly on WVR companies. How will you enforce them without statutory powers?

A breach of the Listing Rules by a company listed on the Exchange with a WVR structure will be enforced in the same way as a breach of Listing Rules by any other company listed on the Exchange. A failure to comply with the Listing Rules in a material manner is grounds for suspension or cancellation of listing under Rule 6.01. A breach of Listing Rules may also result in disciplinary proceedings against the issuer and/or its directors under Chapter 2A of the Listing Rules.

The relevant WVR safeguards will be built into the Listing Rules using compulsive language to make enforcement possible. The Exchange will also require, to the extent legally permissible, for some of the safeguards to be incorporated into the constitutional documents of the issuer to provide shareholders with a ground for civil action through the Courts if necessary.

In the event of a possible breach of the relevant WVR safeguards or the triggering of a circumstance in which WVR must fall away, the Exchange’s proceedings will comply with the same due process requirements as those applicable to a proceeding for a possible breach by any other listed company, with the delivery of show cause letters requiring rectification of the breach within a specific period failing which, for example, suspension may be directed as a protective measure. Ultimately a hearing before the Listing Committee as decision maker would normally be required for which the relevant established procedures would be followed. The Exchange will develop processes as part of the second consultation to conduct the proceedings in a fair and efficient manner.

Depending on the circumstances, the Listing Committee would be asked to make appropriate directions for remedial action or a direction for a WVR holder to give up his or her WVR shares, to be carried out within a specific timeframe. The Exchange may constrain access to the market by the Company or an individual director through a cold shoulder order; suspension or ultimately cancellation unless the direction is complied with. Further, if the Listing Committee had decided that a holder is no longer entitled to WVR shares, the Exchange would withhold its listing approval (in the case of an issuance of listed securities) or its approval for the issuance of a shareholders’ circular (in the case of a material transaction requiring a circular) if the WVR holder purports to have contributed to the approval of a matter in contravention of the Exchange’s decision on the holder’s entitlement to WVR.

10. Which companies qualify for the new secondary listing route?

The Exchange proposes to modify the existing Listing Rules in relation to overseas companies (and make consequential changes to the Joint Policy Statement Regarding the Listing of Overseas Companies jointly issued by the SFC and the Exchange in September 2013 (2013 JPS)) to create a new route to a secondary listing to attract issuers from emerging and innovative sectors and those with a primary listing on the New York Stock Exchange, NASDAQ or the Main Market of the London Stock Exchange (and belonging to the UK FCA's "Premium Listing" segment), each a Qualifying Exchange. Other issuers will still be able to apply for a secondary listing in Hong Kong under the existing secondary listing regime in Chapter 19 and the 2013 JPS.

The new secondary listing route to be set out in the amended Listing Rules will only be available to applicants with all of the following characteristics:

a) innovative company by reference to the characteristics set out in FAQ No. 2 above;
b) a primary listing on a Qualifying Exchange;
c) a good record of compliance for at least two years on a Qualifying Exchange; and
d) an expected minimum market capitalisation at listing of $10 billion.

Applicants with the above characteristics would be established innovative companies regulated under a robust regulatory regime with a legal framework similar to Hong Kong. The requirement for a good record of compliance for at least two years will also reduce the risk of regulatory arbitrage by potential applicants.

On this basis, the Exchange proposes the following measures to attract the targeted companies to secondary list in Hong Kong:

a) eligible companies will not be subject to the "centre of gravity" test, which will permit eligible companies from the Greater China region to secondary list in Hong Kong;

b) (i) eligible companies from the Greater China region and listed on a Qualifying Exchange prior to the publication of the Consultation Conclusions; and (ii) eligible international companies will be able to secondarily list in Hong Kong without having to change their existing governance structure and WVR structure (instead these companies will be required to comply with certain key shareholder protection measures as conditions of continued listing); and

c) eligible companies will have the benefit of the automatic Listing Rule waivers currently available to established secondary listing applicants under the 2013 JPS.

To mitigate the risk of regulatory arbitrage, the Exchange requires Greater China companies listed on a Qualifying Exchange after the publication of the Consultation Conclusions to comply with Hong Kong WVR requirements and demonstrate that they are subject to shareholder protection standards at least equivalent to those in Hong Kong by changing their constitutional documents as necessary.

11. What happens if the bulk of trading in the shares of companies with a secondary listing via the new concessionary route migrates to Hong Kong?

For the first time we will be removing the barrier to companies with a "centre of gravity" in Greater China from a secondary listing in Hong Kong. It is likely that these companies will attract greater interest from Hong Kong investors than the secondary listings of Non-Greater China Companies. Consequently, there is a possibility that the majority of trading in the shares of these companies will, at some point, migrate from the company's exchange of primary listing to Hong Kong.

In these circumstances, we believe it would not be appropriate to place reliance upon the regulatory regime in operation in the overseas jurisdiction of primary listing. We state in our Way Forward that, if this happens, the codified automatic waivers granted to Greater China Companies will no longer apply. These companies would be treated as having a dual-primary listing and would, on a case by case basis, be granted only waivers that are commonly granted to dual-primary listed issuers.

Grandfathered Greater China Companies (i.e. those listed on a Qualifying Exchange before the publication of today's Conclusions) with WVR structures would also need to comply with the Hong Kong WVR safeguards applicable to primary listings to the extent that the safeguards are not inconsistent with their existing governance structure and which do not require a change to their constitutional documents. Non-Grandfathered Greater China Companies with WVR structures would already be in compliance with these WVR safeguards as it would be a requirement of their listing.

Companies would be given a 12 month grace period to comply with the applicable requirements following a migration of the bulk of trading in their securities to Hong Kong.

The Exchange would determine that the bulk of trading of the shares of a company had migrated to Hong Kong if 55 per cent or more of the total trading volume in the shares of the company took place on the Exchange in the company's most recent fiscal year.

12. How will the Takeovers Code apply to companies' secondary listing under the new concessionary route?

Consistent with the listing policy of accommodating the listings of innovative issuers and for competition purposes, the SFC have indicated that their current thinking is that the Takeovers Code would not apply to secondary listings of Greater China Companies in so far as they would be regarded as "public companies in Hong Kong" for the purposes of the Takeovers Code. However, if the bulk of trading moves to Hong Kong and therefore a company is treated as having a dual primary listing in Hong Kong, the Takeovers Code would apply at that point. Further consideration will be given to this after the publication of today's Conclusions. It is anticipated that any consultation on the Takeovers Code that may follow would be separate to the Exchange's planned Rules consultation.

13. Will there be any eligibility requirements for investors accessing the companies listed under the two new chapters?

The Exchange has proposed to introduce two new chapters to the Main Board Listing Rules, meaning the investor eligibility requirements will be the same as with the current Main Board.

14. What is the view of the HKSAR Government and the SFC on the Exchange's latest proposals?

Since the Concept Paper's consultation period closed, HKEX has had considerable dialogue with the SFC regarding the issues covered in this paper and the proposed way forward for attracting issuers from emerging and innovative sectors has been determined following these discussions.

The HKSAR Government attaches great importance to enhancing Hong Kong's competitiveness as an international financial centre. It has publicly supported upholding market quality while actively seeking to further develop and broaden our capital markets.

15. What will be the Exchange's next steps and timeframe for implementing the new listing regime?

The Exchange is in the process of finalising the proposals and has commenced the drafting of the proposed amendments to the Listing Rules to put the proposals into effect. The Exchange intends to further refine the proposals through discussions with stakeholders. It will then conduct a formal consultation on the detailed proposals and proposed amendments to the Listing Rules.

The Exchange expects to begin the discussions shortly after the publication of these Consultation Conclusions with a view to proceed with the formal consultation on the proposed Rule amendments in the first quarter of 2018.

16. Will the implementation of the expanded listing regime require law changes?

The proposed way forward will involve amendments to HKEX's Listing Rules, but will not require any changes to Hong Kong law.