

FAQs on Proposed New Listing Regime for Emerging and Innovative Companies

23 Feb 2018

General

1. Has the SFC been consulted on your consultation proposals and do they support them?

The Exchange has had extensive discussions with the SFC since the end of the consultation period for the New Board Concept Paper in August 2017. Both the Proposed Way Forward in the New Board Concept Paper Conclusions as well as the Proposals in this consultation paper reflect not only the feedback from the market but also the regulatory discussions with the SFC. The Listing Rule changes following the consultation will need to be approved by the SFC board.

2. Why are you conducting a four-week consultation only?

The New Board Concept Paper Conclusions published in December 2017 outlined the proposed way forward, based on market feedback, to broaden the listing regime to facilitate the listing of issuers from emerging and innovative sectors. The proposals in the consultation paper generally reflect the conclusions. Hong Kong has discussed the core issues for a few years already so the consultation period is sufficient for the market to provide meaningful feedback without unnecessary delays to the process.

3. When could prospective issuers submit questions relating to the proposed new regime?

After the Exchange publishes its conclusions to the consultation paper, a prospective listing applicant and its sponsor(s) may submit a formal pre-IPO enquiry regarding the interpretation of the published final Listing Rules and their application to the prospective listing applicant's circumstances. Before then, the Exchange will respond to any such enquiries on an informal basis.

4. When do you expect you will start taking listing applications under the new regime?

The deadline for consultation submissions is 23 March 2018. If there are no major adjustments to the proposals following the consultation, we expect to publish the consultation conclusions in late April at the earliest. Upon the publication of the conclusions and the implementation of the Listing Rules, the Exchange will accept formal listing applications under the new regime.

Biotech/Pre-Revenue Issues

5. What would be considered as a pre-revenue Biotech Company that is suitable to list on the Exchange?

As set out in the New Board Concept Paper Conclusions, we aim to attract issuers from the Biotech sector that are engaged in research and development for the purposes of developing and commercialising products, processes or technologies that are subject to regulation by a Competent Authority, such as the US Food and Drug Administration, the China Food and Drug Administration, and the European Medicines Agency.

6. Would the listing threshold for Biotech Companies be too high, particularly the minimum market cap requirement?

The proposed minimum market capitalisation of \$1.5 billion is based on an extensive analysis of the market, feedback from sector experts and regulatory input from the SFC. We are confident that this level will meet the needs of issuers that have reached the stage of development set out above, while taking into consideration the interests of investors, such as having healthy aftermarket liquidity.

7. Will the vetting process for listing applications involving pre-revenue biotech companies differ from other applications? Will the Exchange seek help from industry experts when assessing Biotech Companies?

The vetting process in terms of application procedures, review of disclosure and Listing Committee review will be identical to that for other Main Board applicants. The Exchange acknowledges that our experience with Biotech issuers is still limited and, therefore, we are considering how best to engage expert advice on applications where needed.

- 8. A Biotech Company won't be allowed to effect a transaction that would result in a fundamental change to its principal business without the Exchange's prior consent. Will the Exchange have sufficient knowledge or expertise to judge a Biotech Company's plan? Would that restrict the companies' legitimate business plans?**

The Exchange has sought and received extensive expert advice in relation to the appropriate suitability criteria for Biotech issuers, including the proposed restriction on a fundamental change of the Biotech Company's principal business. The consultation paper seeks market feedback on the guidance.

The proposed measure is not intended to restrict legitimate business development and consent will normally be given if the Biotech Company can demonstrate that it is engaging in legitimate business expansion or diversification as part of its business strategies. Where necessary, the Exchange will seek specialist advice to assist in its determination.

- 9. How will the Exchange engage expert advice on Biotech?**

The Exchange is looking to bring in experienced people both at the Listing Department level and the Listing Committee level to enhance its ability to make assessments on issuers in this field. Where needed, the Exchange will continue to draw on external expertise.

- 10. It is expected that there will be a large number of listing applications from biotech pre-revenue companies that meet the criteria. How will the Exchange decide on which companies will be able to list first?**

It is standard practice for the Exchange to begin to review applications as we receive them. Some applications of course take longer than others to review, depending on the number of comments and issues raised on an application.

- 11. A Biotech company needs to receive meaningful third party investment from at least one Sophisticated Investor at least six months before the date of the proposed listing. Why is there this requirement? How do you define "Sophisticated Investor"?**

In the absence of the usual metrics of revenue and cash flow for valuation purposes, this measure has been introduced to ensure that a reasonable degree of acceptance exists for a prospective issuer's product. A Sophisticated Investor is determined by the Exchange by

reference to factors such as net assets or assets under management, relevant investment experience, and the investor's knowledge and expertise in the relevant field.

12. How will HKEX determine whether pre-revenue biotech issuers have failed to meet the requirement of maintaining sufficient operations or assets? Will the accelerated delisting process be extended to companies in other sectors?

The assessment for compliance with our Listing Rules on maintaining sufficient operations or assets will be similar to those for companies from any sector listed on our Main Board. In terms of the de-listing process generally, we recently consulted on this and will publish our conclusions in due course.

13. Why does HKEX propose to apply the restrictions on cornerstones only on the biotech pre-revenue category and not for the WVRs and, more broadly, for new listings in general?

Companies applying for a listing under the proposed Biotech chapter do not have traditional indicators of performance (e.g. revenue and profit) as a measure of its value. As such, there is a greater emphasis on ensuring a market-driven pricing process to determine if these companies are able to meet the proposed market capitalisation requirement. The proposed restriction on cornerstone investors will help reduce the influence of pre-arranged deals on the book-building process and will also help ensure that the pricing process for the IPOs of such companies is as market-driven as possible.

Weighted Voting Rights (WVR)

14. The term “innovation” still seems quite vague. Can you more clearly define what is considered “innovative”?

The Exchange recognises that what is considered “innovative” depends on the state of the industry(ies) and market(s) in which an applicant operates, and will change over time as technology, markets and industries develop and evolve. For this reason we have provided guidance on the characteristics that the Exchange will take into account in determining whether the applicant is an innovative company. These are set out in paragraph 106 of the consultation paper. An innovative company would normally be expected to possess more than one of the following characteristics:

- its success is demonstrated to be attributable to the application of (1) new

technologies; (2) innovations; and/or (3) a new business model to the company's core business, which also serves to differentiate the company from existing players;

- R&D is a significant contributor of its expected value and constitutes a major activity and expense;
- its success is demonstrated to be attributable to its unique features or intellectual property; and/or
- it has an outsized market capitalisation / intangible asset value relative to its tangible asset value.

15. Could you give an example of what is the application of “a new business model to the company’s core business”?

The creation of a new way of connecting consumers and providers could be considered an example of the application of a new business model.

16. What are the investor protection measures?

The investor protection measures closely reflect the proposals that we set out in the New Board Concept Paper Conclusions and are summarised as follows:

First, an applicant needs to demonstrate that it is both eligible and suitable to list with a WVR structure. In this connection the company must be an innovative company, must have a track record of high business growth and have received external validation through meaningful third party pre-IPO investment.

The applicant must have a high expected market capitalisation at listing (at least \$10 billion, and if it is expected to have a market capitalisation of \$40 billion or less, with \$1 billion in revenue in its most recently audited financial year.).

Ring-fencing will be put in place to ensure that WVR structures do not become commonplace by ensuring that only new applicants can list and that WVRs cannot be increased, after listing, in proportion to the issuer's ordinary shares holding one vote per share.

WVR beneficiaries must collectively hold at least 10 per cent of the underlying economic

interest in the application's total issued share capital at the time of listing. This is to ensure that the interests of WVR beneficiaries are aligned, at the outset, with the interests of other shareholders. To help justify their need for weighted voting rights, they must also hold 50 per cent or less of the voting rights in the company at the time of listing.

WVR beneficiaries must be directors at listing and thereafter to ensure that they have continued involvement in the company and to ensure that they are subject to the duties of a director under the law and the Listing Rules.

WVR will fall away via a "natural sunset" if the beneficiary dies, is incapacitated, or ceases to be a director. These rights will also fall away if the rights, or the shares to which they are attached, are transferred to another person.

The WVR power that can be carried by shares will also be capped to ten votes per share and WVR issuers must ensure that non-WVR shareholders can always cast at least 10 per cent of the total number of votes that are available to be cast on resolutions at a general meeting. The Exchange will also require that a company cannot set the threshold for shareholders to call a general meeting any higher than 10 per cent of the voting rights on a one-share, one-vote basis.

Importantly, certain matters must always be subject to voting on a "one-share, one-vote" basis. These matters are: (a) changes to the issuer's constitutional documents; (b) variation of the rights attached to a class of shares; (c) the appointment or removal of independent non-executive directors; (d) the appointment or removal of auditors; and (e) the voluntary winding-up of the issuer.

The Exchange has also put in place enhanced disclosure rules that will require an issuer with a WVR structure to warn investors in their listing documents, share certificates and ongoing communications that they are a WVR issuer and that investors should therefore exercise caution when investing. WVR issuers will also be differentiated on trading screens with a "W" stock marker.

Lastly, the Exchange will require WVR issuers to meet enhanced corporate governance requirements. They must establish a corporate governance committee that will have a duty to review and monitor the issuer's compliance with the investor protection measures set out above. This committee must report in the issuer's annual and interim reports on its

performance of this role. WVR issuers will also be required to hire a compliance adviser on an ongoing basis (rather than for a limited time after listing) to ensure that they are able to seek advice whenever necessary on compliance with the Listing Rules.

17. With regards to the requirement to add WVR safeguards into companies' constitutional documents, as well as the required undertaking provided by WVR beneficiaries, are these the Exchange's answers to address concerns that Hong Kong lacks a class action lawsuit regime?

The Exchange believes that class actions are not a necessary pre-requisite to allowing issuers to list with WVR structures in Hong Kong. In the US, class action cases are most often brought to seek remedies for matters relating to disclosure of information (e.g. providing false information in registration statements, failure to disclose material adverse facts in public records, etc.) and not for the abuses of control that possibly arise under a WVR structure.

The Exchange currently requires companies with one-share, one-vote governance structures to incorporate Listing Rule requirements into their constitutional documents (e.g. to provide investors with investor standards that are equivalent to that of Hong Kong law). Consequently, incorporating these measures into the Exchange's Listing Rules for WVR companies merely ensures that the existing regulatory tools available to us are brought fully to bear when we administer the regime.

In addition, the Exchange also proposes WVR beneficiaries to provide an undertaking to the issuer that they will comply with the relevant WVR safeguards, which will expressly confer benefit on the issuer and all existing and future shareholders of the company with the intention that such third parties have a legal basis on which to seek to enforce the terms of the undertaking against the WVR beneficiary.

18. Why are there no time-defined sunset clauses for WVR beneficiaries? How does HKEX determine if a director is "incapacitated", thus deeming the weighted voting related to the beneficiary shares lapsed?

Tying WVR to individual persons will provide a "natural" time-defined sunset as the WVRs must cease on the death or incapacity of the individual or if he ceases to be a director or transfers his WVR shares. This means that the WVRs will never exist forever.

Other markets, particularly the US, do not mandate a time-defined sunset clause and voluntary adoption of this requirement is very rare. Consequently, we believe that mandating it for applicants to list in Hong Kong may result in the vast majority of potential applicants seeking a listing with WVR structures elsewhere rather than listing in Hong Kong.

The incapacity of a WVR beneficiary will be judged case-by-case based on the circumstances. In general, the Exchange would consider a WVR beneficiary to be incapacitated if he is unable to perform his duties as a director.

19. Why is the WVR voting power capped at no more than 10 times the voting power of ordinary shares? What is the rationale?

Capping the voting power that can be carried by WVR shares places a limit on the degree of control that a WVR beneficiary can have in proportion to his economic interest and so will limit the risk of expropriation.

20. Why is the HKEX proposing to have the 10 per cent minimum WVR shareholding requirement at the time of listing only, and not on an ongoing basis after listing?

The requirement for WVR beneficiaries to, collectively, hold at least 10 per cent economic interest in the issuer at the time of listing helps ensure that, to some extent, the interests of the WVR beneficiaries are aligned with the interests of other shareholders.

This cap is only placed at listing and not afterwards because, if the WVR beneficiaries' economic interest reduces after listing, their voting power will reduce proportionately.

21. Why would HKEX only allow share-based WVR structures for primary listings, and not consider other WVR structures?

Share-based structures are the most common WVR structure and the most familiar to investors. It is also a structure which could be accommodated under the existing framework of the Takeovers Code. On the other hand, non-share-based structures may be more complex and less easy for investors to understand, and therefore the potential risks may not be as apparent.

22. What are the duties of the compliance adviser apart from being “consulted” by the company on WVR matters? Does this role have any real powers, ie like those of an auditor?

Compliance advisers to a WVR issuer will have a duty to provide advice on compliance with rules and regulations as well as WVR specific matters. As of now, they will only be required to provide advice at the request of the issuer.

23. What kind of authority does the Corporate Governance Committee hold in addition to “reviewing” and “monitoring” corporate activity? Will certain corporate decisions require the committee’s sign off?

WVR issuers will be free to set up their own internal rules and procedures regarding the role of the Corporate Governance Committee. This means that they could, on a voluntary basis, require the committee to sign off on certain corporate decisions. However, this is not a requirement that is included in our proposals. Ultimately, responsibility for the actions of the issuer must lie with its board, even if it does delegate certain responsibilities to committees.

In addition to reviewing and monitoring corporate activity, a corporate governance committee must report on its activities in the issuer’s interim and annual reports.

24. How does HKEX see allowing corporate beneficiaries of WVR companies? Generally what are the arguments for or against this?

As highlighted in the consultation paper, the Exchange has received feedback from a number of market participants that the Exchange should permit corporates to benefit from WVRs as well. The feedback suggests that there are legitimate commercial reasons for corporates to seek WVRs and not allowing corporates to benefit from WVRs may significantly limit the competitiveness of the proposed regime.

As stated in the consultation paper, allowing corporate beneficiaries to benefit from WVRs would be a significant new development from the proposed way forward in the New Board Concept Paper Conclusions and require a comprehensive analysis of the issues. Accordingly, we intend to explore the option of allowing corporate WVR beneficiaries in a separate consultation.

25. Why would HKEX allow other types of WVR structures for secondary listings only?

The proposed concessionary secondary listing route is designed to facilitate the secondary listing of innovative companies. The “grandfathered” applicants for secondary listing are already listed in the US or the UK with their existing structures, and did so without knowledge of the regime that we are now proposing for secondary listing (and they did not do so for the purpose of regulatory arbitrage).

It is difficult for these companies which are already listed to change their WVR structure, and it would be unreasonable to require them to do so. Therefore, it is necessary to permit them to list with their existing WVR structure in order to attract them to list in Hong Kong. To prevent regulatory arbitrage, companies from the Greater China region listed after the publication of the New Board Concept Paper Conclusions will not have the benefit of being able to list with their existing non-conforming WVR structure.

Secondary Listings

26. Aren't the proposed Listing Rules tailor made for certain Mainland Chinese companies listed in the United States to list in Hong Kong via secondary listings after the proposed Listing Rule changes?

The proposed concessionary secondary listing route is designed to facilitate the secondary listing of innovative companies. The proposed Listing Rule amendments are tailored to enhance the competitiveness of our regime. In doing so, we aim to strike a balance between facilitating listings of innovative companies and providing appropriate investor protection. In this context, we are proposing facilitative measures for companies already listed in the US or the UK before the publication of the New Board Concept Paper Conclusions, as it is difficult for these companies to change their existing structure, and these companies had no knowledge of our proposals when they listed in the US or the UK (and therefore did not do so for the purpose of regulatory arbitrage). We are also proposing facilitative measures for non-Greater China companies as well.

27. Were these major Mainland Chinese companies consulted as you finalised the recommendations?

We have received feedback from prospective issuers based on the Proposed Way Forward set out in the New Board Concept Paper Conclusions. However, we did not discuss in

detail our proposals with the companies mentioned above before the publication of the proposals.

28. Why is it that (non-Chinese and Grandfathered Chinese) secondary listings of WVR companies need not comply with the proposed ongoing WVR safeguards that apply to primary listings, and in particular, the restriction not to increase the weighting of WVR shares, and the requirement for certain resolutions to be subject to a one share, one vote basis?

Applicants under the proposed concessionary secondary listing regime are primarily issuers listed in the US, and the US remains the primary source of regulation for these companies. The US does not prescribe the above WVR restrictions as part of its regime. It may not be appropriate for them to change their governance structure for the sake of a listing in a venue that is not their primary venue of trading, and requiring them to do so will significantly impact the competitiveness of the proposed secondary listing regime. Applicants will be required to clearly disclose the regulations (and associated risks) to which they are subject to allow investors to make an informed decision whether to invest in them.

To prevent regulatory arbitrage, Non-Grandfathered Greater China Issuers (i.e. those listed after the publication of the New Board Concept Paper Conclusions) will be required to comply with the above WVR safeguards.

29. How do you determine if the bulk of trading in the shares of an issuer migrates to Hong Kong on a permanent basis?

The Exchange considers the bulk of trading in the shares of an issuer to have migrated to Hong Kong on a permanent basis if 55 per cent or more of the total trading volume of those shares over the issuer's most recent fiscal year takes place on the Exchange's markets.

Ends