NOW + NEXT

ASIA PACIFIC LAW ALERT | NIXON PEABODY LLP

APRIL 27, 2018

NP

Hong Kong Stock Exchange brings in landmark changes to allow weighted voting right shares

By James Griffiths and Cecilia McKenzie

The new rules will come into effect on 30 April 2018 and bring to an end a four-year debate over whether Hong Kong should allow new listing applicants to adopt WVR structures after the decision by some high-profile technology companies to list in the United States in preference to Hong Kong. The new rules form part of three initiatives for which HKSE is adding new chapters in the Main Board Listing Rules ("Listing Rules") and making consequential changes to the current Listing Rules. The new initiatives will (a) permit listings of companies with WVR structures; (b) permit listings of biotech issuers that do not meet any of the financial eligibility tests of the HKSE's Main Board; and (c) establish a new concessionary secondary listing route for greater China and international companies that wish to secondary list in Hong Kong. This alert focuses solely on the changes implemented with respect to WVR structures.

The revised Listing Rules closely follow HKSE's proposed way forward in its conclusions to the New Board Concept Paper published in December 2017. They have been controversial in part because of the historic difference in approach between the US securities regime (as a disclosure-based regime, backed by strict enforcement and the prospect of litigation for inaccurate disclosures) and the Hong Kong securities regime, which has operated more as a principles-based regulatory regime, with equal treatment of shareholders and "one vote per share" being core values applied by the HKSE in determining the suitability of an applicant for listing. The new rules seek to forge a compromise between the two approaches to regulation, given the perceived need for the HKSE to become more attractive to companies from emerging and innovative sectors in the current competitive environment.

The HKSE has implemented a new Chapter 8A of the Listing Rules and a new Guidance Letter setting out the qualifications for listing for companies with a WVR structure and the safeguards that must be put in place to protect investors on an ongoing basis. A summary of the key features of the proposed new regime is set out below.

Qualifications for listing on the Hong Kong Stock Exchange

To be suitable for listing, a company with a WVR structure will have to meet the following criteria:

— It must be a new applicant for listing.

- It must be an "innovative company", meaning:
  - its success is demonstrated to be attributable to the application to the company's core business of (a) new technologies, (b) innovations and/or (c) a new business model, which also serves to differentiate the company from existing players;
  - R&D is a significant contributor to 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
  - it has an outsized market capitalisation/intangible asset value relative to its tangible asset value.
- It must have a minimum expected market capitalisation of HK$10 billion at the time of listing, and at least HK$1 billion of revenue in its most-recent audited financial year if it has an expected market capitalisation at listing of less than HK$40 billion.
- It must demonstrate a track record of high business growth, which can be measured objectively by operational metrics such as business operations, users, customers, unit sales, revenue, profits and/or market value (as appropriate), and its high growth trajectory must be expected to continue.
- It must have previously received meaningful third-party investment from at least one sophisticated investor (which must remain at IPO) who will be required to retain an aggregate of 50% of their investment at the time of listing for a period of at least six months post-IPO.
- Its WVR beneficiaries must be restricted to individuals who (a) are directors of the applicant at the time of listing; (b) have an active executive role within the business and have contributed to a material extent to the ongoing growth of the business; and (c) in circumstances where the value of the company is largely attributable or attached to intangible human capital, have been materially responsible for the growth of the business, by way of their skills, knowledge and/or strategic direction.

It should be noted that the HKSE plans to launch a separate consultation by 31 July 2018 to explore the option of allowing corporate entities to benefit from WVRs. The consultation paper will ask for feedback on whether, and the basis on which, corporate entities should be able to benefit from WVRs.

Investor safeguards

The Listing Rules contain (among others) the following investor safeguards:

- An issuer's WVR structure must be attached to a specific class of shares that confers only enhanced voting rights on the beneficiary, and such shares must be unlisted.
- WVR beneficiaries must be restricted to those who are and remain as directors of the issuer, meaning that any WVR rights attaching to such beneficiaries shall lapse if the beneficiary (a) ceases to be a director, (b) dies or is incapacitated, or (c) transfers their WVRs to another person (save for certain partnership, trust or private company arrangements).
- The WVR beneficiaries must beneficially own collectively at least 10% of the underlying economic interest in the applicant's total issued share capital at the time of listing (subject to possible reduction in the percentage where the applicant has an exceptionally large market

capitalization at the time of listing).

- Issuers with WVR structures are prohibited from increasing the proportion of WVR shares in issue or from issuing any further WVR shares after listing (save in pro rata offerings).
- The voting power attached to WVR shares must be capped at not more than 10 times of the voting power of the ordinary shares.
- Non-WVR shareholders must be entitled to cast at least 10% of the votes that are eligible to be cast at general meetings, and the minimum holdings of non-WVR shareholders who wish to convene a general meeting or add resolutions at a general meeting must not be higher than 10% of the voting rights on a one-share one-vote basis in the share capital of the listed issuer.
- After listing, there must be no change in the rights attached to WVR shares to increase the WVR attaching to those shares.
- Changes to the issuer's constitutional documents, the variation of rights attached to any class of shares, the appointment and removal of independent non-executive directors ("INED") and auditors, and the voluntary winding-up of the issuer must be voted on a one-share, one-vote basis.
- Issuers with WVR structures must establish a nomination committee (to recommend the appointment or re-appointment of directors), which must be chaired by an INED.
- Issuers with WVR structures must establish a Corporate Governance Committee composed entirely of INEDs (one of which must act as chair of the committee) and must engage a compliance adviser on a permanent basis. The Corporate Governance Committee must (among other things) confirm compliance with the WVR rules on an annual basis.
- WVR safeguards must be incorporated into an issuer's constitutional documents, and WVR beneficiaries must give undertakings to the issuer that they will comply with such WVR safeguards.
- Issuers with WVR structures will be identified through a stock marker "W" at the end of their stock names.
- Issuers with WVR structures must disclose in their listing documents and annual and interim reports the identity of all WVR beneficiaries, the impact of a potential conversion of WVR shares into ordinary shares and all the circumstances in which the WVRs attaching to their shares will cease.
- Issuers with WVR structures are required to include the warning "A company controlled through weighted voting rights" on the front page of all corporate documents, and to describe their WVR structure, the rationale for having a WVR structure, and the associated risks for shareholders in their listing documents and periodic financial reports.

The new rules can be expected to help the HKSE compete more effectively against the US and other exchanges in attracting innovative companies to list in Hong Kong, particularly tech unicorns from the PRC, with Xiaomi being a widely touted early contender.

For more information about the content of this alert, please contact your Nixon Peabody attorney or:

- James Griffiths at **james.griffiths@nixonpeabodycwl.com** or +852-2171-6238
- Cecilia McKenzie at **cmckenzie@nixonpeabodycwl.com** or +852-2171-6412