

26 February 2018

Hong Kong Stock Exchange publishes draft Listing Rules for the listing of biotech companies and innovative companies with WVRs, and the secondary listing of companies with a centre of gravity in Greater China and/or WVRs

Key takeaways

1. **There are no surprises.** The draft Listing Rules closely follow the proposals announced by the Hong Kong Stock Exchange in December 2017. Companies with WVRs and which demonstrate “the necessary characteristics of innovation and growth” will be eligible to list in Hong Kong. Unfortunately, there is no new insight as to what constitutes “innovative”.
2. **New regime will come soon.** The Hong Kong Stock Exchange is working on an expedited timetable. The consultation period for the draft Listing Rules will end on 23 March 2018. Although a date has not been set, the new regime could be in place as early as end of April this year.
3. **Start your engines.** Notwithstanding the new Listing Rules not having been finalised, the Exchange will respond to pre-IPO enquiries on the listing of companies which may satisfy the criteria in the proposed new rules on an informal basis now. Formal pre-A1 submissions can be made after publication of the consultation conclusions, and listing applications can be submitted after the new regime comes into effect.

Introduction

Last Friday, the Hong Kong Stock Exchange (the “**Exchange**”) published the **Consultation Paper on The Listing Regime for Companies from Emerging and Innovative Sectors**. It sets out three proposed new chapters to be added to the current Listing Rules to allow:

- a. the primary listing of companies with weighted voting rights (“**WVR**”) structures that demonstrate “the necessary characteristics of innovation and growth” (Chapter 8A);
- b. the primary listing of biotech companies that do not meet any of the financial eligibility tests in Rule 8.05 (Chapter 18A); and
- c. the secondary listing of companies already listed on a Qualifying Exchange¹, including those with WVR structures or a “centre of gravity” in Greater China (Chapter 19C).

There are no surprises in the draft Listing Rules as they follow closely the proposals announced in the Exchange’s New Board Concept Paper Consultation Papers published in December 2017. Indeed, many of our previous questions and concerns remain unanswered (see our **client alert** for our commentary on the proposals announced in December 2017), and the initial application of these new chapters by the Exchange will likely take some trial and error. Nevertheless, the proposed new rules mark a new dawn for the Exchange and should prove exciting for the market.

In this client alert, we provide a short summary of each of the three proposed new chapters of the Listing Rules. Set out in the **Appendix** are also easy-to-use checklists to help determine whether a company could be eligible under each of these three proposed new chapters.

¹ Qualifying Exchanges are initially limited to the NYSE, NASDAQ, and the Premium Listing segment of the LSE.

Primary listings of companies with WVR structures

Consistent with the proposals in December 2017, there are three key concepts which new applicants seeking to list with WVR structures must comply with under the proposed new Chapter 8A:

- First, a new applicant is expected to demonstrate “*the necessary characteristics of innovation and growth and the contribution of the proposed beneficiaries of WVRs*”. Interestingly, the reference to innovation and growth is only set out in the introduction to Chapter 8A and not expressly in the body of the rules. Instead, the rules provide that the new applicant must demonstrate to the Exchange that “it is both eligible and suitable for listing with a WVR structure”. This language, similar to the “suitable for listing” language used in Rule 8.04, is intended to give the Exchange maximum flexibility to reject an application even if it satisfies all the objective requirements. Indeed, the Exchange has made it clear that potential applicants should not rely on market precedents to ascertain whether their business model or technology would be considered “innovative”. Chapter 8A itself does not contain any guidance as to what constitutes “innovation and growth”, but the characteristics of “innovation” set out in the Consultation Paper (which are the same as those set out in the proposals in December 2017) will be incorporated into guidance letters. Further details are set out in the Appendix.
- Second, beneficiaries of WVRs will be restricted to *individuals* who are directors of the applicant at listing and remain directors afterwards (although individual directors may hold their WVRs through trusts, private companies, partnerships, etc.). The Exchange has not opened the door for corporate beneficiaries of WVRs (e.g., a spin-off with the parent company retaining WVRs), although the Exchange said it would revisit this by launching a separate consultation three months after the current proposed new rules come into effect. One new concept in the proposed new rules is a requirement that the beneficiaries of WVRs, collectively, must hold at least 10% and not more than 50% of the underlying economic interest in the applicant’s total issued share capital at the time of listing. In addition, WVRs will be structured as a separate class of unlisted shares not held through CCASS – lenders taking pledges over WVR shares will need to consider implications for their enforcement mechanics and Pt XV disclosure of interest questions will need to be answered.
- Third, the Exchange has prescribed a detailed list of safeguards which are required to accompany the use of WVR structures. These include requiring pre-IPO investors to be subject to a partial 6-month lock-up, a limit on the voting power attached to WVRs (non-WVR holders must have a minimum 10% of voting rights at a general meeting), certain corporate actions at a general meeting not being subject to WVRs, and enhanced disclosure and corporate governance measures. In addition, when the WVRs are lost, the WVR shares must convert into ordinary shares at a 1:1 ratio. The safeguards are broadly the same as those set out in the December 2017 proposals.

Pre-revenue, pre-profit biotech companies

In the December 2017 proposals, the Exchange said biotech companies with products which have satisfied certain developmental milestones may be eligible for listing notwithstanding their inability to fulfil the financial eligibility tests in Rule 8.05. These milestones are now set out in the proposed new Chapter 18A, breaking down by product individual milestones for pharmaceutical products (small molecule drugs), biologics, medical devices (including diagnostics) and other biotech products. These product milestones are set by reference to the regulatory regimes of “Competent Authorities”, which initially are limited to the Food and Drug Administrations of the US and China, and the European Medicines Agency.

In addition to having products which have satisfied specific developmental milestones, the other eligibility requirements can be divided into two buckets:

- **Listing applicant eligibility requirements**, which focus on the applicant having a track record in biotech R&D, it owning or in-licensing relevant intellectual property over its products (with the in-licensing

permission bringing about some tension with the R&D track record), and whether it has had meaningful historical third-party investment from at least one “sophisticated financial investor”.

- **IPO transaction-specific requirements**, which include requirements such as the applicant achieving a minimum HK\$1.5 billion market capitalisation at the time of listing (and, based on our experience, could be challenging for this type of companies and act as a bit of a gatekeeper), it maintaining working capital to cover at least 125% of the applicant group’s costs for at least the next 12 months, and a requirement that shares held by cornerstone investors are not to be counted as part of the applicant’s public float.

The Exchange stressed that a biotech listing applicant is still subject to general suitability for listing tests. This means the objective satisfaction of the listing applicant eligibility requirements set out above does not mean definitively that a biotech listing applicant will be eligible for listing. Once listed, in addition to existing requirements under the Listing Rules, these biotech companies will be subject to more stringent ongoing monitoring and compliance requirements. A biotech company is not permitted to effect acquisitions, disposals or other transactions that result in a fundamental change to its principal business unless it can be demonstrated to the Exchange that it is a legitimate business expansion or diversification as part of its business strategy. In addition, a shorter, 12-month de-listing period will apply if the biotech company fails to meet its continuing obligation to maintain sufficient operations or assets.

Concessionary secondary listing regime

Similar to the proposals from December 2017, a company already primary listed on a Qualifying Exchange with a WVR structure and a “centre of gravity” in Greater China may nevertheless seek a secondary listing in Hong Kong. The key eligibility requirements are that the applicant demonstrates necessary characteristics of innovation and growth and the contribution, that it has a good record of compliance for at least two full financial years on a Qualifying Exchange, and that it has a minimum market capitalisation of HK\$10 billion.

Once an applicant’s eligibility under this route is established, what happens next depends on (a) whether the applicant has a “centre of gravity” in Greater China; and if yes, (b) whether the overseas primary listing occurred on or before 15 December 2017. It appears this distinction is not driven by what is appropriate protection for investors in Hong Kong, but a desire to avoid requiring existing overseas listed companies from having to make changes to their existing governance structures.

In particular, an applicant without a “centre of gravity” in Greater China and an applicant with a “centre of gravity” in Greater China but which was primary listed overseas before December 2017 do not have to carry out the detailed “equivalent shareholder rights” comparison exercise (which is typically time consuming and costly) provided that they satisfy certain basic shareholder rights. They are also exempted from the Exchange’s other requirements applying to VIE structures (e.g., the “narrowly tailored requirement”) and WVR structures. An applicant with a “centre of gravity” in Greater China and primary listed overseas after 15 December 2017 does not have the benefit of these exemptions.

Timetable

The current consultation period on the draft new rules will end on 23 March 2018. Although a date has not been set, the new regime could be in place as early as end of April this year. Importantly, the Exchange has said that while formal pre-IPO enquiries should only be made after the consultation conclusions are published, the Exchange will from now on respond informally to enquiries regarding the application of the final rules and their application to a prospective listing applicant’s circumstances.

If you would like to discuss any of the points in detail, please contact your usual Linklaters contact.

Appendix – Is your company eligible under the new Chapters?

Primary listings of companies with WVR structures

1. Is the company suitable for WVR structures?

Is the company innovative?

- Is the success of the company attributable to the application of (1) new technologies; (2) innovations; and/or (3) a new business model to the company's core business? Do they differentiate the company from other existing players?
- Has the company's business model been adopted by other industry players over time?
- Has the company developed an "innovative" way of deploying existing technologies?
- Is R&D a significant contributor to the company's expected value and constitutes its major activity and expense?
- Is the company's success attributable to its unique features or intellectual property?
- Will the company have an outsized market capitalisation upon listing?
- Is the company's intangible asset value very high relative to its tangible asset value?
- Have the company's business or assets been listed before?

Does the company have a track record of high business growth?

- Can the growth be objectively measured by operational metrics such as business operations, users, customers, unit sales, revenue, profits and/or market value?
- Is the high growth trajectory expected to continue?

Have the proposed beneficiaries of WVRs contributed in any unique way to the company's development?

- Are the proposed beneficiaries of WVRs individuals?
- Have the proposed beneficiaries of WVRs made material contributions to the growth of the company by way of their skills, knowledge and/or strategic direction in circumstances where the value of the company is largely attributable or attached to intangible human capital?

Has the company had external validation?

- Has the company had meaningful third-party investment from sophisticated investors which remain at IPO?
- Will these pre-IPO investors agree to having at least 50% of their investment locked up for 6 months post-IPO?

Is the company big enough?

- Will the Company achieve expected market capitalisation of at least HK\$10 billion at the time of listing?
- If the expected market capitalisation is less than HK\$40 billion, does it have a minimum revenue of HK\$1 billion in the most recent audited financial year?

2. Who will hold the WVRs?

- Will the proposed beneficiaries of WVRs be executive directors of the company with ongoing responsibility for the company's performance at the time of listing?
- Beneficiaries of WVRs must collectively own at least 10% but no more than 50% of the economic interest in the company at listing.
- Will the WVRs be held in the form of additional voting rights attaching to a separate class of unlisted shares?

3. Will the company accept the following safeguards as a condition to using WVR structures?

Restrictions on the limit of WVRs

- After listing, the company cannot increase the proportion of shares with WVRs in issue or to issue any further WVR shares. This includes situations where the number of non-WVR shares is reduced following a share buyback.
- WVRs will be limited to share based structures with capped voting power (not more than 10 times voting power of ordinary shares). Non-WVRs holders must be entitled to cast at least 10% of the votes on a resolution proposed at a general meeting.
- Certain fundamental issues affecting the company (e.g., changes to the constitutional documents, variation of class rights and, importantly, the appointment and removal of INEDs and auditors) are to be determined on a one share one vote basis.
- There will be restrictions on the WVR beneficiary's ability to transfer the WVRs attached to the shares and the WVRs will fall away when the beneficiary ceases to be a director, no longer meet the requirements of a director, dies or becomes incapacitated.

Major enhanced corporate governance measures

- Engagement of a compliance adviser on a permanent basis
- Constitutional backing for the WVR safeguards to allow private legal action by shareholders.
- The company must have a corporate governance committee comprised of a majority of INEDs to monitor the company's compliance with the Listing Rules.

Pre-revenue, pre-profit biotech companies

1. Is the company a biotech company?

Has the company developed at least one Core Product beyond the concept stage?

- Are the company's products required by applicable laws, rules or regulations to be evaluated and approved by a Competent Authority (such as the Food and Drug Administrations of the US and China and the European Medicines Agency) based on data derived from clinical trials before it could be marketed ("**Core Products**")?
- Has at least one of such Core Products gone beyond the concept stage? For example, has the product completed Phase I clinical trials and received the Competent Authority's no objection to commence Phase II clinical trials? Has the product been categorised as a Class II medical device or above and completed at least one clinical trial on human subjects without objections from the Competent Authority for further clinical trials or commencement of sales?

Does the company have a suitable track record?

- Has the company be primarily engaged in biotech R&D for at least two financial years prior to listing under substantially the same management?
- Has the company been engaged with the R&D of its Core Products for a minimum of 12 months prior to listing?
- Does the company have durable patents, registered patents, patent applications and/or intellectual property in relation to its Core Products?

Has the company had external validation?

- Has the company had meaningful third-party investment from sophisticated investors at least 6 months prior to listing, and which remain at IPO?

2. Does the proposed IPO satisfy relevant requirements?

- Is the primary reason for listing the raising of finance for R&D to bring the company's Core Products to commercialisation?
- Is the expected market capitalisation at listing in excess of HK\$1.5 billion?
- Does it have sufficient working capital to cover at least 125% of the group's costs for at least 12 months from the date of its prospectus, after taking into account the estimated IPO proceeds?
- Will the company achieve minimum public float requirements if cornerstone investors are excluded from the public float until expiry of their six months lock-up period?

3. Will the company accept the following safeguards as condition for its listing?

- The company is not permitted to effect any acquisition, disposal or other transactions which would result in a fundamental change in its principal business activities.
- The company is subject to a shorter, 12-month de-listing period if it fails to meet its continuing obligation to maintain sufficient operations or assets.

Concessionary secondary listing regime

1. Is the company eligible?

Is the company innovative?

- See above for characteristics which demonstrate innovation.

Where is the company's current primary listing?

- Is it primary listed on the NYSE, NASDAQ or the Premium Listing segment of the LSE?
- Does it have a good record of compliance for at least two full financial years?

Is it big enough?

- Will it have expected market capitalisation at the time of secondary listing of at least HK\$10 billion? If the expected market capitalisation is less than HK\$40 billion, will it have at least HK\$1 billion revenue in its most recent audited financial year?

Does it fulfil minimum shareholder protection levels?

- Is a super majority vote of the company's members in general meeting required to approve changes to rights attached to any class of shares, changes to the constitutional documents or to approve a voluntary winding-up?
- Is an existing member of the company's approval required if its liability is to be increased?
- Is the appointment, removal and remuneration of auditors required to be approved by a majority of the company's members or another body that is independent of the company's board of directors?
- Is the company required to hold a general meeting each year as its annual general meeting?
- Are members entitled to reasonable written notice of any general meeting?
- Do members have the right to speak and vote at a general meeting?
- Are members holding a minority stake of at least 10% allowed to convene a general meeting and add resolutions to a meeting agenda?
- Can HKSCC appoint proxies or corporate representatives to attend the company's general meetings with the right to speak and vote?

2. Special requirements applicable to companies which have a "centre of gravity" in Greater China and listed in the Qualifying Exchanges after 15 December 2017

- Does the company have VIE structures, and if yes do they comply with the Exchange's requirements with respect to VIE structures (including the "narrowly tailored" requirement)?
- Does the company have WVR structures, and if yes, do they comply with the Exchange's requirements with respect to WVR structures?

Authors: Rob Cleaver, Craig Dally, Kevin Cheung, Gilbert Li, Alex Bidlake, Iris Yeung, Chris Yip.

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

© Linklaters Business Services (H.K.) Limited. All Rights reserved 2018.

Please refer to www.linklaters.com/regulation for important information on our regulatory position. We currently hold your contact details, which we use to send you newsletters such as this and for other marketing and business communications. We use your contact details for our own internal purposes only. This information is available to our offices worldwide and to those of our associated firms. If any of your details are incorrect or have recently changed, or if you no longer wish to receive this newsletter or other marketing communications, please let us know by emailing us at marketing.database@linklaters.com.

A36050273