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UPDATES ON NEW BOARD CONCEPT PAPER

Hong Kong's Financial Secretary, Mr. Paul Chan, has suggested that tech and other new economy companies with weighted voting rights (**WVR**) structures may be allowed to list on the Main Board of the Hong Kong Stock Exchange, subject to the imposition of appropriate safeguards. It seems therefore that the Stock Exchange is planning to drop proposals put forward in its June 2017 New Board Concept Paper, that listings of such companies should be confined to a newly established third board. A transcript of Mr. Chan's comments was published in a press release¹ issued by the Financial Services and Treasury Bureau on 23 October 2017.

New Board Concept Paper

The Stock Exchange published its New Board Concept Paper² on 16 June 2017 for a two-month public consultation. It proposed a new board, separate from the existing Main Board and Growth Enterprise Market, which would list new economy start-ups and pre-profit companies, with or without WVR structures, on a professionals only "Pro" segment. New economy companies with WVR structures which are able to meet the Main Board's financial tests, would be allowed to list on a "PREMIUM" segment of the new board open to retail and professional investors. New economy Chinese companies with a primary listing on the New York Stock Exchange (**NYSE**) or Nasdaq would also be eligible for a secondary listing on the PREMIUM segment, a move widely seen as aimed at facilitating the secondary Hong Kong listing of companies

such as Alibaba Group Holding Limited (**Alibaba**), Baidu, Inc. and JD.com, Inc., all of which are listed on the New York exchanges. The Concept Paper was subject to a two-month public consultation which concluded on 18 August 2017. Mr. Chan's comments are the first indication of the likely direction of the reforms to date.

For further details of the New Board Concept Paper, please refer to Charltons' June 2017 newsletter³.

Weighted Voting Rights

The question of whether WVR companies should be allowed to list in Hong Kong has been contentious for some time. The issue came to a head when Hong Kong missed out on Alibaba's 2014 listing because the Hong Kong regulators would not grant the company a waiver of certain director nomination rights vested in the company's founders, which were considered to breach Hong Kong's "one share, one vote" (**OSOV**) principle. Alibaba subsequently listed on the NYSE, which allows companies with WVR structures to list, in the largest IPO in history.

A Concept Paper on Weighted Voting Rights was subsequently issued (for further information, please refer to Charltons' September 2014 newsletter⁴). The market response to the listing of WVR companies was generally positive and the Stock Exchange indicated its intention to consult on a straw

1 <http://www.info.gov.hk/gia/general/201710/23/P2017102300827p.htm>

2 <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf>

3 <https://www.charltonslaw.com/hkex-consults-on-proposed-new-board-for-new-economy-companies/>

4 <https://www.charltonslaw.com/hkex-publishes-concept-paper-on-weighted-voting-rights/>

man proposal to allow WVR companies to list subject to certain safeguards. The board of the SFC however indicated that it did not support the Exchange's straw man proposal. For a summary of the SFC's principal objections to the proposal, please see Charltons' October 2015 newsletter⁵.

The prohibition on the listing of companies with WVR structures has hindered Hong Kong's development as a listing venue for China's tech companies, which are among the country's most successful companies. Tech companies with WVR structures, including Baidu Inc. and JD.com, Inc. listed instead in the US. As noted in the 2017 Concept Paper, tech companies, which typically have WVR structures, are among the fastest growing companies. Yet, as of June 2017, they accounted for only 3% of Hong Kong's market capitalisation. Although Hong Kong was the world's top IPO fundraising exchange in 2016⁶, it remains dominated by low-growth, old economy companies, hence its price-to-earnings ratio as at June 2017 was only 13.4 x compared with 32.8 x for Nasdaq.

Requirement for Safeguards

According to the FSTB press release, the FSTB has asked the SFC and the Hong Kong Stock Exchange to consider what safeguards should be put in place for the listing of companies with WVR structures. The Exchange's 2015 Consultation Conclusions on its first WVR Concept Paper had proposed consulting on a number of safeguards including: (i) only allowing WVR structures for new listing applicants; (ii) imposing a requirement for holders of WVRs to maintain a minimum shareholding in the company post-listing; and (iii) deeming holders of WVR rights to be "connected persons" for the purposes of the Listing Rules.

Pre-Profit Companies

The June New Board Concept Paper proposed allowing new economy start-up and pre-profit companies to list on the Pro segment of the new board. Assuming the suggestion that new economy WVR companies will be allowed to list on the Main Board will be taken forward, and the proposal for a new board is dropped, it would seem that start-ups will not be allowed to list.

As regards pre-profit companies, Hong Kong's Main Board already provides two alternative financial tests to the profit test. Its Market Capitalisation/ Revenue Test allows the listing of very large companies with a market capitalisation of at least HK\$4 billion at the time of listing and revenue of at least HK\$500 million for the audited financial year prior to listing. In September 2017, ZhongAn Online P&C Insurance Co., Ltd. listed on the Main Board under this test in a US\$1.5 billion IPO, the largest fintech IPO on the Hong Kong exchange to date. The third test, the Market Capitalisation, Revenue, Cash Flow test allows the listing of companies with a minimum market capitalisation of HK\$2 billion, revenue of HK\$500 million and minimum cash flow from operating activities of HK\$100 million for the three financial years preceding the listing.

⁵ <https://www.charltonslaw.com/hong-kong-drops-weighted-voting-rights/>

⁶ <https://www.charltonslaw.com/hong-kong-is-worlds-top-ipo-fundraising-market-in-2016-while-listed-debt-turnover-rises-126-percent-on-2015/>

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