



Hong Kong

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HKEX PUBLISHES CONSULTATION PAPER ON CORPORATE WVR BENEFICIARIES

On 31 January 2020, HKEx announced¹ the publication of its Consultation Paper on Corporate WVR Beneficiaries,² seeking feedback on a proposal to allow corporate entities to benefit from weighted voting rights (**WVR**) subject to additional conditions and investor protection measures. Under the current regime, WVR can only be held by individuals.

The latest consultation is a follow-up to the HKEx Listing Rule reforms implemented on 30 April 2018 which allow tech and other innovative companies with WVR to list on the Main Board under Chapter 8A, as well as secondary listings of such companies which are primary listed on a Qualifying Exchange (currently the NYSE, Nasdaq and the “Premium Listing” segment of the London Stock Exchange’s Main Market) under Chapter 18A. The new route to secondary listing for tech companies with WVR was also opened to Mainland Chinese companies which were previously barred from secondary listing in Hong Kong by the HKEx/SFC Joint Statement on the Listing of Overseas Issuers³ which prohibited secondary listings of companies with a “centre of gravity” in China. The new avenue for secondary listings bore fruit with Alibaba Group Holding Limited’s US\$12.9 billion secondary listing on HKEx, which was the second largest IPO globally in 2019, after Saudi Aramco, and propelled HKEx back to the top of

the rankings for IPO fund raising markets, for the second year running and the sixth time in the last 10 years. For details of the current regime for listing WVR companies on HKEx, please see Charltons’ April 2018 newsletter.⁴

HKEx had proposed in its April 2018 Consultation Conclusions on A Listing Regime for Companies from Emerging and Innovative Sectors⁵ (**April 2018 Consultation Conclusions**) that it would launch a separate consultation by 31 July 2018 on allowing corporate entities to hold WVRs, following feedback from stakeholders that this should be permitted in discussions with HKEx (paragraphs 15 and 16 of the Consultation Conclusions). That further consultation was deferred in an announcement on 25 July 2018.

The present consultation seeks views on HKEx’s proposed corporate WVR regime and safeguards to address the associated risks which include suitability and eligibility requirements, ongoing requirements and a time-defined sunset period renewable with the approval of independent shareholders.

The cut-off date for responding to the consultation is **1 May 2020** and responses can be submitted using the questionnaire

1 https://www.hkex.com.hk/News/News-Release/2020/200131news?sc_lang=en

2 HKEx. Consultation Paper: Corporate WVR Beneficiaries. January 2020. Available at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/January-2020-Corporate-WVR/Consultation-Paper/cp202001.pdf?la=en>

3 https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Other-Resources/Listing-of-Overseas-Companies/Joint-Policy-Statement-20130927/new_jps_0927.pdf

4 Charltons. Consultation Conclusions on WVR Listings. April 2018. Available at: <https://www.charltonslaw.com/consultation-conclusions-on-wvr-listings/>

5 HKEX. Consultation Conclusions: A Listing Regime for Companies from Emerging and Innovative Sectors. April 2018. Available at: [https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-\(April-2018\)/cp201802cc.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-(April-2018)/cp201802cc.pdf)

available at <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/January-2020-Corporate-WVR/Questionnaire/cp202001q.docx>.

I HKEx Key Proposals for Corporate WVR Beneficiaries

A corporate entity will be eligible to hold WVR if it, or the company of which it is a wholly owned subsidiary, satisfy specified suitability and eligibility criteria on the date of listing and meet certain continuing requirements on an ongoing basis. The most important of these are summarised below:

Suitability Requirements for Corporate WVR Beneficiaries

1. A corporate WVR beneficiary must:
 - be an Innovative Company or have a track record of investments in, and contributions to, Innovative Companies;
 - have held an economic interest of 10% in, and been materially involved in the listing applicant's business, for two financial years prior to the listing application; and
 - have an economic interest of 30% in the listing applicant at the date of listing.
2. The corporate WVR beneficiary's contribution to the listing applicant must be of a type that is not easily replicated or substituted. Financial investments or non-financial contributions (such as knowhow or strategic advice) are not sufficient to allow a shareholder to hold WVR.
3. A prospective corporate WVR holder must demonstrate that it owns and operates an "ecosystem" at listing (and on an ongoing basis) that benefits the listing applicant. Key requirements for the ecosystem are that:
 - it comprises a community of companies including the listing applicant and other components (which could be business units of the corporate shareholder, user or customer bases, applications, programs or other technological applications) that has grown and co-evolved around a technology or know-how platform or a set of core products or services, owned or operated by the prospective corporate WVR beneficiary;

- its components, including the listing applicant, benefit from, and contribute to, the ecosystem by sharing data, users, and/or technology (e.g., software);
- it has attained a meaningful scale (normally measured by reference to indicators such as the number and technological sophistication of its components, size of its user base, extent and frequency of cross-interaction between the users or customers of different components);
- its core components and the listing applicant, are in substance controlled by the corporate WVR beneficiary; and
- the listing applicant's growth and success was materially attributable to its participation in and co-evolution with the ecosystem, and it is expected to continue to benefit materially from being part of that ecosystem.

Eligibility Requirements for Corporate WVR Beneficiaries

1. A corporate WVR beneficiary must be primary listed on HKEx or on a Qualifying Exchange.
2. It must have a minimum market capitalisation of HK\$200 billion.
3. The listing applicant must not represent more than 30% of the corporate WVR beneficiary in terms of market capitalisation.
4. WVRs of a corporate beneficiary cannot carry more than five times the voting power of the ordinary shares.

Continuing Requirements

1. A corporate WVR beneficiary must:
 - have at least one corporate representative on the board of directors of the listed issuer;
 - remain listed on HKEx or a Qualifying Exchange; and
 - continue to own a 30% economic interest in the listed issuer.
2. WVRs held by a corporate beneficiary will lapse after a time defined "sunset" period of no more than 10 years, but can be renewed for successive periods of no more than five years with the approval of independent shareholders.

- WVRs held by a corporate beneficiary will lapse permanently if its contribution to the WVR issuer is substantially terminated or materially disrupted or suspended for 12 months or more.

II Reasons for Allowing Corporate WVR Beneficiaries

The Consultation Paper on Corporate WVR Beneficiaries sets out the following reasons for allowing corporate entities to benefit from WVR:

1. Development of Innovative Companies

The Consultation Paper notes that innovative companies often operate in a broader “ecosystem” that includes other companies in the same corporate group and independent companies. This is particularly true for a large number of sizeable, unlisted Mainland companies from emerging and innovative sectors.

The reasons outlined for expanding the current regime are:

- A significant number of the largest unlisted Mainland companies in emerging and innovative sectors are associated with a recognised ecosystem which has materially contributed to and shaped their growth. When these companies list, the ecosystem leader will continue to influence their strategy, development and prospects after the IPO;
- It may benefit listing applicants if they are able to continue to evolve with the other companies in their ecosystem. The ecosystem leaders accelerate the growth of the listing applicant through strategic guidance, channeling users and sharing other synergistic benefits, which would be difficult to replicate without the ecosystem;
- As argued by the FSDC in their response to the February 2018 Consultation Paper on a Listing Regime for Companies from Emerging and Innovative Sectors⁶ (**February 2018 Consultation Paper**), preventing a corporate parent from holding WVRs to maintain control, may remove a company from the ecosystem which is instrumental to its performance;⁷ and

⁶ HKEx. February 2018. Consultation Paper: A listing regime for companies from emerging and innovative sectors. Available at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Consultation-Paper/cp201802.pdf>.

⁷ See: **FSDC response** to the February 2018 Consultation Paper.

- It may be in the interest of the listing applicant to grant WVR to a corporate shareholder who is the ecosystem leader as it would encourage it to include the listing applicant in its common vision for the ecosystem, providing the listing applicant with a competitive advantage and reinforcing their position in the ecosystem.

2. Reasons for Corporate Shareholders to Seek WVR

The Consultation Paper outlines the following reasons why corporate shareholders may seek WVR both at IPO and after listing:

- At IPO – to maintain control of the unicorn company they have incubated;
- After listing – to retain the balance of control or consolidate control where the issuer’s business forms a crucial part of their ecosystem; or
- To gain more than 50% voting power and consolidate the WVR issuer into their financial results.

3. Diversifying the Hong Kong Market

HKEx’s June 2017 New Board Concept Paper⁸, which considered allowing the listing of companies with WVR structures, noted the Hong Kong market’s lack of diversity and high sector concentrations. As of November 2019, financial and property sectors still made up 38% of HKEx’s total market capitalisation,⁹ while companies from innovative and emerging sectors made up only 10% (excluding Alibaba).

This compared to NASDAQ, NYSE and LSE where innovative and emerging companies made up 69%, 55% and 24% of total market capitalisation, respectively.¹⁰

HKEx outlines the concern that this lack of exposure to high growth sectors may lead to stagnation and a lack of investor interest.

Accordingly, given that WVR structures are features of many emerging and innovative companies, the proposed corporate WVR regime has the potential to contribute to diversifying the market.

⁸ <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/Concept-Paper-on-New-Board/cp2017061.pdf>

⁹ HKEx as of November 2019.

¹⁰ Bloomberg as of December 2019.

Competitive Considerations

The Consultation Paper notes that of 91 Mainland issuers with WVR structures that listed on US exchanges between 2010 and November 2019, 38 (42%) had corporate WVR beneficiaries.

Of those 38:

- 15 (16%) granted WVR to fund corporate shareholders only;
- 13 (14%) granted WVR to non-fund corporate shareholders only; and
- 10 (11%) granted WVR to both.

HKEx also notes that Mainland emerging and innovative issuers have listed in the US with corporate WVR beneficiaries, with Youdao, Tencent Music Entertainment and Huya being recent examples. All three companies had a market capitalisation above HK\$10 billion, the threshold for WVR listing in Hong Kong.

Furthermore, of the 23 Mainland WVR issuers with non-fund corporate WVR beneficiaries:

- 13 had a market capitalisation greater than HK\$10 billion at listing (and accordingly would have met the minimum market capitalisation threshold in the Listing Rules for companies with WVR structures);
- 9 of those 13 had a market capitalisation of between HK\$10 to 40 billion; and
- 4 of those 13 had a market capitalisation greater than HK\$40 billion.

With this in mind, HKEx encourages the expansion of the regime to accommodate corporate WVR beneficiaries, citing concerns that if not amended:

- Companies, for whom this is an issue, may continue to choose to list in the US, over Hong Kong; and
- Investors will lose out on opportunities to invest in a more diverse range of companies in their home market.

III Risks and Concerns Regarding Corporate WVR Beneficiaries

The Consultation Paper notes the following principal concerns relating to allowing corporate WVR beneficiaries.

1. Risk of Misalignment of Shareholders' Interests

One of the risks associated with corporate WVR beneficiaries is the risk of greater misalignment between the interests of a listed company's controlling shareholder and those of the rest of the company's shareholders as a whole. Empirical studies have argued that the lower the economic interest of controlling shareholders in a company, the greater the risk of them extracting benefits from the company for themselves to the detriment of the other shareholders.¹¹ The Consultation Paper highlights that allowing corporates to control companies through WVR structures exacerbates the misalignment of shareholders' interests since controlling shareholders are able to maintain control while holding a disproportionately smaller equity interest in a company.

The problem is potentially aggravated where a corporate WVR beneficiary has a controlling shareholder with a WVR structure. Controlling shareholders would thus be able to exercise majority voting power in a listing applicant with only a small and indirect stake in the company, creating a greater risk of misalignment of interests between the ultimate controlling shareholder and the listing applicant's other shareholders.

2. Risk of WVR Structures Becoming More Widespread

The Consultation Paper notes the concern that allowing corporates to benefit from WVR may result in WVR structures becoming commonplace in Hong Kong. This concern was raised by fund managers and corporate governance associations in response to the February 2018 Consultation Paper. For example, the Asian Corporate Governance Association in their submission¹² outlined concern for a scenario where acquisitive WVR companies would then "*spawn additional WVR companies with a cascading loss of*

¹¹ For example, Rafael La Porta, Florencio Loped-de-Silanes, and Andrei Shleifer and Robert W. Vishny. (1999). Investor protection and corporate governance. Stijn Claessens, Simeon Djankov and Larry H.P. Lang. (2000). The separation of ownership and control in East Asian Corporations. Mara Faccio and Larry H. P. Lang. (2002). The ultimate ownership of Western European corporations.

¹² [https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Responses-\(April-2018\)/cp201802r_211.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Responses-(April-2018)/cp201802r_211.pdf)

governance rights for investors". According to the Consultation Paper, 91 Mainland companies with WVR listed on US exchanges between 2010 and November 2019, of which 38 (42%) had given WVR to corporate shareholders. 25 of those 38 companies had issued WVR shares to private equity/venture capital companies whose holdings were primarily a financial investment.

In response to these concerns, HKEx outlines two potential solutions:

- i) to restrict WVR to corporate shareholders that play a pivotal role in an ecosystem from which the listing applicant materially benefits. This would however require HKEx to make a subjective judgement as to:
 - a) the existence of the ecosystem; and
 - b) the nature and extent of the corporate shareholder's contribution to the listing applicant.
- ii) to employ a high financial eligibility requirement, for example a high market capitalisation, to limit WVR to a smaller number of companies.

There are however two concerns with the latter solution:

- a) there is no universally recognised financial eligibility criteria that could differentiate between corporates that play a pivotal role in an ecosystem and those that do not; and
- b) a high financial eligibility requirement would create an uneven playing field, favouring well-established tech giants at the expense of smaller but potentially innovative companies.

3. WVR Could be Exercised by Corporates Without Owning Fiduciary Duties to the Company and Shareholders

Under the current regime, an individual beneficiary's WVR will lapse if the person:

- ceases to be a director;
- is no longer able to perform the duties of a director; or

- is deemed (by HKEx) to no longer meet the requirements of a director.

This is to ensure that the individual WVR beneficiary owes fiduciary duties to the WVR issuer and its shareholders and is accountable and responsible for its performance.

Comparatively, corporates cannot act as directors and therefore cannot owe fiduciary duties to the issuer. Senior management and the board of a corporate WVR beneficiary will also not owe any fiduciary duty or other responsibility to the listing applicant or its shareholders, unless they are also appointed to the board of the listing applicant.

4. The Senior Management / Board of a Corporate WVR Beneficiary may not have made the Requisite Contribution to Justify Exercising the WVR

An individual WVR beneficiary is permitted to exercise WVR on the basis of the skills, knowledge, and/or strategic direction that have materially contributed to the issuer's growth and success prior to listing, and the regime prohibits the transfer of WVRs to other persons, as they have not made this contribution.

As regards corporate shareholders, the concern is that the senior management and/or board of the corporate WVR beneficiary will change over time, and they may not have made a contribution to justify their exercise of WVR.

This concern was raised by The Hong Kong Investment Funds Association in their submission¹³ to the February 2018 Consultation Paper¹⁴ which noted the potential creation of a secondary market for "control ownership".

IV HKEx Proposed Requirements for Corporate WVR Beneficiaries

The HKEx consultation proposes to amend Chapter 8A of the Listing Rules and either issue a new guidance letter or amend existing HKEx Guidance Letter HKEx-GL93-18¹⁵ on Suitability for Listing with a WVR Structure (the **WVR Guidance Letter**)

¹³ [https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Responses-\(April-2018\)/cp201802r_269.pdf](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Responses-(April-2018)/cp201802r_269.pdf)

¹⁴ <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Consultation-Paper/cp201802.pdf>

¹⁵ https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/g//gl9318.pdf

to permit corporate entities to benefit from WVR, subject to additional conditions and safeguards aimed at balancing the benefits of extending the regime while mitigating the risks.

The HKEx proposals would require a corporate WVR beneficiary to meet both suitability and eligibility requirements. The corporate WVR beneficiary must either meet these requirements itself, or be a wholly-owned subsidiary of another entity which meets the requirements. The proposal is aimed at giving WVR holders the flexibility to hold WVR shares through a special purpose vehicle (SPV), and ensuring that the management and board or directors of the entity meeting the eligibility and suitability requirements are the only persons able to direct the voting of the WVR shares.

HKEx will not require the WVR of a corporate WVR beneficiary to cease on a change in control of the corporate WVR beneficiary, stating that this would amount to a poison pill.

V HKEx Proposed Suitability Requirements for Corporate WVR Beneficiaries

1. Nature of Corporate WVR Beneficiary

HKEx proposes to restrict corporate WVR beneficiaries to companies with business experience in emerging and innovative sectors. It is thus proposed that a corporate WVR beneficiary must either be an Innovative Company itself or have a track record of investment in, and contributions to, Innovative Companies.

An Innovative company is one with the characteristics set out in paragraph 4.2 of the WVR Guidance Letter, i.e. a company with two or more of the following characteristics:

- i) 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;
- ii) research and development is a significant contributor of its expected value and constitutes a major activity and expense;
- iii) its success is demonstrated to be attributable to its unique features or intellectual property; and/or
- iv) it has an outsized market capitalisation / intangible asset value relative to its tangible asset value.

2. Corporate WVR Beneficiaries' Minimum Economic Interest

Individual beneficiaries of WVR are required to collectively beneficially own 10% of the underlying economic value in a listing applicant's total issued share capital at the time of listing (HKEx Listing Rule 8A.12). The aim of this requirement is to ensure that at the time of listing, the economic interest of the WVR beneficiaries as a group is sufficient in dollar terms to align their combined interests with those of the company's other shareholders. Individual beneficiaries are not however required to maintain this aggregate 10% interest on an ongoing basis after listing.

10% Underlying Economic Interest and Material Involvement in the Listing Applicant for 2 Years Before Listing

In order to be eligible as a corporate WVR beneficiary, HKEx is proposing that the company must have:

- i) held an economic interest of at least 10% in the listing applicant; and
- ii) been materially involved in the listing applicant's management or business (e.g. through the listing applicant's business being part of its ecosystem),

for at least two financial years prior to the date of the listing application.

30% Economic Interest of Corporate WVR Beneficiary at and after Listing

HKEx also proposes that at the time of listing, a corporate WVR beneficiary must:

- i) beneficially own at least 30% of the underlying economic interest in the listing applicant's total issued share capital; and
- ii) be the single largest shareholder (save for any individual WVR beneficiary).

A corporate WVR beneficiary that holds an economic interest between 10% and 30% during the two financial years before the listing date will be allowed to increase its shareholding to 30% in compliance with the Listing Rules and HKEx-GL43-12

“Guidance on Pre-IPO Investments”¹⁶ and HKEx-GL85-16 “Placing to Connected Clients and Existing Shareholders or their Close Associates, under the Rules”¹⁷.

The 30% economic interest requirement will be an ongoing requirement, and the WVR attached to a corporate WVR beneficiary’s shares will lapse if it fails to maintain a 30% interest.

The proposals recognise that with an interest of 30%, a corporate WVR beneficiary would be regarded as having “de facto control” of the relevant listing applicant even without WVR, and would be considered a controlling shareholder under the HKEx Listing Rules and the Hong Kong Takeovers Code.

The Consultation Paper on Corporate WVR Beneficiaries also notes that this proposal may put Hong Kong at a competitive disadvantage compared to US exchanges which have no minimum economic interest requirement for corporate WVR beneficiaries. It notes that 38% of non-fund corporate investors holding WVR in 23 US-listed Mainland companies held an economic interest below 30% at listing. Accordingly, HKEx invites views on whether a lower level of economic interest (at least 20%) may be appropriate in conjunction with the other proposed conditions.

Exception from Shareholders’ Approval Requirement for Share Issues on a Non-Pre-emptive Basis

The HKEx Listing Rules prohibit listed issuers from issuing shares on a non-pre-emptive basis without a specific or general mandate approved by shareholders (LR 13.36).

If the proposed requirement that corporate WVR beneficiaries must hold at least a 30% economic interest in the issuer on an ongoing basis is adopted, HKEx proposes to introduce an exception to the above-mentioned prohibition.

Accordingly, the proposal is to permit an issuance of shares on a non-pre-emptive basis to a corporate WVR beneficiary without shareholders’ approval provided that:

- i) the subscription is solely for the purpose, and to the extent necessary, to allow a corporate WVR beneficiary to comply with the 30% economic interest requirement;
- ii) the shares do not carry WVR;
- iii) the subscription is on the same or better terms (from the perspective of the listed issuer) as the original issuance that required the corporate WVR beneficiary to subscribe for additional shares to comply with the 30% economic interest requirement; and
- iv) the subscription price paid by the corporate WVR beneficiary for the anti-dilution shares is fair and reasonable, having regard (among other things) to the average trading price of the listed issuer’s shares over the preceding three months.

HKEx may also require the listed issuer to demonstrate the reasonableness of the subscription price paid by a corporate WVR beneficiary, particularly where the original issue of shares was as consideration for acquisitions or there are indications that it was not conducted at arms’ length. An independent financial adviser’s opinion may therefore be required in some situations.

3. Corporate WVR Beneficiaries’ Contribution to an Ecosystem

For an individual beneficiary to qualify for WVR it must be demonstrated that the person:

- i) has an active executive role within the business; and
- ii) was materially responsible for the growth of the listing applicant.¹⁸

The Consultation Paper on Corporate WVR Beneficiaries is proposing that for a listing applicant to grant WVR to a corporate beneficiary, they must be able to demonstrate the existence of an ecosystem between them at listing and on an ongoing basis. The ecosystem must have the following characteristics:

¹⁶ <https://www.hkex.com.hk/-/media/hkex-market/listing/rules-and-guidance/interpretation-and-guidance-contingency/guidance-letters/guidance-letters-for-new-applicants/gl43-12>

¹⁷ https://en-rules.hkex.com.hk/sites/default/files/net_file_store/new_rulebooks/g/l/gl8516.pdf

¹⁸ See: Para. 4.4 and 4.5 of the WVR Guidance Letter.

- A community of companies which includes the listing applicant and other components (which could be non-legal entities such as business units of the corporate shareholder, user or customer bases, applications, programs or other technological applications) that has grown and co-evolved around a technology or know-how platform or a set of core products or services, owned or operated by the prospective corporate WVR beneficiary (although such platform, products or services need not represent the main business of the corporate WVR beneficiary);
- The components within the ecosystem, including the listing applicant, both benefit from, and contribute to, the ecosystem by sharing certain data, users, and/or technology (for example, software, applications, proprietary knowhow or patents);
- The ecosystem has attained a meaningful scale which will normally be measured by reference to indicators such as the number and technological sophistication of the components connected to the ecosystem, the size of its user base, or the extent and frequency of cross-interaction between the users or customers of different components;
- The core components within the ecosystem, and the listing applicant, are in substance controlled by the corporate WVR beneficiary; and
- The growth and success of the listing applicant was materially attributable to its participation in and co-evolution with the ecosystem, and the listing applicant is expected to continue to benefit materially from being part of that ecosystem.

A corporate WVR beneficiary's contribution to a listing applicant must be of a nature that cannot be easily replicated or substituted by other means. Accordingly, a mere financial investment or ordinary non-financial contribution would not be enough to allow a corporate shareholder to hold WVR. Private equity / venture capital companies would not be eligible to become WVR beneficiaries.

The Consultation Paper on Corporate WVR Beneficiaries notes that while the term "ecosystem" is mostly used in the context of technology companies, traditional economy companies such as financial services conglomerates can also develop a similar

network of innovative companies and other components around a technology-enabled platform and core products or services to form such an ecosystem.

HKEx invites views on whether there are other circumstances (relevant to innovative companies) that may justify the granting of WVR to a corporate shareholder.

VI HKEx Proposed Eligibility Criteria for Corporate WVR Beneficiaries

1. Corporate WVR Beneficiary to be Primary Listed on HKEx or a Qualifying Exchange

Corporate WVR beneficiaries will be required to be primary listed on the HKEx or on a Qualifying Exchange (the NYSE, Nasdaq and the "Premium Listing" segment of the London Stock Exchange's Main Market). The proposal is aimed at ensuring that the conduct of corporate WVR beneficiaries is subject to the regulatory oversight of a reputable regulatory regime.

The WVR attached to shares held by a corporate WVR beneficiary will lapse if it ceases to be listed on HKEx or a Qualifying Exchange.

2. Size of Corporate WVR Beneficiary

Minimum Market Capitalisation Requirement

It is proposed that a corporate WVR beneficiary must have an expected market capitalisation of at least HK\$200 billion both:

- i) on the day of the listing; and
- ii) based on its average market capitalisation over the preceding three months.

HKEx recognises in the Consultation Paper on Corporate WVR Beneficiaries that imposing a high market capitalisation requirement will restrict the number of companies potentially eligible to hold WVR to well-established tech companies at the expense of smaller innovative companies. The aim is to reduce the risk of companies with WVR structures becoming commonplace in Hong Kong, a concern expressed by large investment funds and corporate governance associations in

responding to the HKEx's original February 2018 Consultation Paper.¹⁹

According to the Consultation Paper on Corporate WVR Beneficiaries, only 297 companies (or 4%) of the 7,903 companies primary listed on HKEx or a Qualifying Exchange had a market capitalisation of HK\$200 billion or more as at December 2019.

Accordingly, HKEx invites views on the proposed market capitalisation requirement and whether any exceptions should be provided.

Listing Applicant Size Relative to Corporate WVR Beneficiary

As a further step to limit the number of companies with corporate WVR beneficiaries, HKEx proposes to require that the listing applicant must not represent more than 30% of the corporate WVR beneficiary in terms of market capitalisation at the time of its listing.

This proposal is also aimed at preventing existing issuers from introducing a WVR structure over a material part of their business/assets.

3. Maximum Votes per Share for Corporate WVR Beneficiaries

Shares held by individual WVR beneficiaries can carry a maximum of 10 times the voting power of ordinary shares.

HKEx proposes that shares held by a corporate WVR beneficiary should carry no more than five times the voting power of ordinary shares.

Accordingly, if a corporate WVR beneficiary held the minimum 30% economic interest, it could have a maximum of 68% of the voting power at general meetings.

This proposal aims to cap a corporate WVR beneficiary's control of a listed issuer and minimise the effect of any misalignment of interests between the controlling and minority shareholders.

VII Ongoing Requirements for Corporate WVR Beneficiaries

¹⁹ <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Consultation-Paper/cp201802.pdf>

1. Corporate Representative

It is proposed that a corporate WVR beneficiary must have at least one corporate representative on the board of directors of the listed issuer at the time of listing and on an ongoing basis.

A corporate representative must be an officer (i.e. a director, manager, secretary or other person involved in the management of the company) of the corporate WVR beneficiary who, in his or her capacity as a member of the board of directors of a WVR issuer, acts as a representative of the corporate WVR beneficiary.

HKEx proposes that WVR attached to a corporate WVR beneficiary's shares would lapse permanently where:

- i) the beneficiary no longer has a corporate representative on the listed issuer's board of directors for a continuous period of 30 days (unless there are justifiable grounds for absence);
- ii) the corporate representative is disqualified by a court or tribunal or found to be an unsuitable director by HKEx due to a decision or action taken in his or her capacity as a director of the listed issuer (except where this decision or action can be shown to have been taken outside the scope of the authority granted to the corporate representative by the corporate WVR beneficiary); or
- iii) the corporate WVR beneficiary has been convicted of an offence involving fraud or dishonesty.

The proposals relating to the corporate representative are aimed at:

- mitigating the risk of a corporate WVR beneficiary avoiding responsibility/accountability for the performance of the issuer;
- providing for supervision and control over the conduct of the corporate WVR beneficiary; and
- ensuring that a corporate WVR beneficiary is not deprived of its WVR for actions or decisions taken by a corporate representative, for which it was not responsible.

2. Sunset Clause

A concern amongst respondents to the February 2018 Consultation Paper was that WVR structures could exist indefinitely. The Listing Rules provide that WVR held by an individual WVR beneficiary will lapse on the individual's death. As corporate entities have no natural limit to their lifespan, one concern arising in relation to corporate WVR beneficiaries is that the WVR structure could exist indefinitely.

HKEx proposes that the WVR of a corporate WVR beneficiary should be subject to a time-defined sunset of not more than 10 years, with the option for indefinite renewal for further periods of five years by the approval of independent shareholders.

The Consultation Paper on Corporate WVR Beneficiaries describes how event-based sunset clauses are common among Mainland US-listed WVR issuers, with the following triggering sunset:

- the transfer of WVR shares to any person or entity that is not an affiliate as defined in the prospectus; and
- the aggregate number of WVR shares falling below a certain threshold.

The former is the most common, with 34 of 38 companies having such a clause.

Position where Corporates and Individuals Benefit from WVR in the Same Issuer

HKEx proposes that a listing applicant should not be prohibited from concurrently having both a corporate WVR beneficiary and individual WVR beneficiaries, provided both meet the relevant suitability requirements.

It is also proposed that individual WVR beneficiaries and a corporate WVR beneficiary of the same issuer need not be subject to the same sunset provisions.

Corporate WVR Sunset

However, HKEx acknowledges that independent shareholders may be reluctant to vote down a renewal of a corporate WVR beneficiary's WVR, if the result would be that the control of individual WVR beneficiaries would substantially increase on a proportionate basis.

Accordingly, HKEx proposes that if the WVR attached to a corporate WVR beneficiary's shares fall away at the end of the sunset period, any individual WVR beneficiary will be required to convert part of his or her WVR shares into ordinary shares, such that they control the same proportion of voting power both before and after the corporate WVR beneficiary's WVR fall away.

Individual WVR Sunset

It is also proposed that a corporate WVR beneficiary's WVR should be unaffected by an individual WVR beneficiary's "event-based" sunset. Thus, the proportionate voting power enjoyed by a corporate WVR beneficiary (and other remaining individual WVR beneficiaries) may increase when the sunset on an individual's WVR is triggered.

A listing applicant also has the option of linking the event-based sunset of individuals with those of a corporate WVR beneficiary.

3. Ongoing Requirement to Provide Access to the Qualifying Ecosystem

HKEx proposes that if the corporate WVR beneficiary's contribution to the WVR issuer (for example, the WVR issuer's access to information and technologies within the ecosystem and the inclusion of the issuer in the WVR beneficiary's overall vision and planning for the ecosystem) is substantially terminated or materially disrupted or suspended for more than 12 months, the WVR attached to the corporate WVR beneficiary's shares will lapse permanently.

4. WVR Issuer's Corporate Governance Committee

6-monthly Confirmations of Lack of Grounds for WVR Termination

HKEx Listing Rule 8A.30 requires a WVR issuer to establish a corporate governance committee to review and monitor all risks relating to the issuer's WVR structure. Accordingly, HKEx proposes that the corporate governance committee should also be required to confirm (on a six monthly and annual basis) that, having made due enquiries with the executive officers of the WVR issuer and such other enquiries as they consider appropriate, they are not aware of any grounds for the termination of the WVR attached to a corporate WVR beneficiary's shares.

Review of Connected Transactions

A corporate WVR beneficiary's provision of an ecosystem that materially benefits a listed WVR issuer is likely to result in transactions between them being required to comply with HKEx's Listing Rule requirements for continuing connected transactions. Chapter 8A, which would also apply to listed issuers with a corporate WVR beneficiary, extends the connected transactions regime by requiring the corporate governance committee to review and monitor all risks related to connected transactions and make a recommendation to the board on each of them.

HKEx invites views on whether any other conditions or requirements should be imposed on WVR beneficiaries or issuers on an ongoing basis.

VIII Responding to the Consultation

The consultation period will remain open until 1 May 2020. Those interested in responding may:

Complete the online questionnaire, available at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/January-2020-Corporate-WVR/Questionnaire/cp202001q.docx>

Or, send written comments by:

Mail or hand delivery to:	Hong Kong Exchanges and Clearing Limited 8th Floor, Two Exchange Square 8 Connaught Place Central Hong Kong Re: Corporate WVR CP
Fax to:	(852) 2524 0149
Email to:	response@hkex.com.hk Please mark in the subject line: Re: Corporate WVR CP

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