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Hong Kong Drops Weighted Voting Rights

On 5 October 2015, the Listing Committee of The Stock Exchange of Hong Kong Limited (**SEHK**) published its decision[1] to not proceed with its draft proposal to allow companies with weighted voting rights (**WVR**) structures to list in Hong Kong in certain limited circumstances. The decision was made in light of the statement[2] issued by the Securities and Futures Commission (**SFC**) on 25 June 2015 summarising its main objections to SEHK's draft proposal.

The Listing Committee expressed the view that the draft proposal "represented its best effort" at dealing with concerns about WVR structures, and in particular ensured appropriate ring-fencing and safeguards. The Listing Committee and the Listing Department have considered whether it would be possible to modify the draft proposal in a way that would address the SFC's stated concerns while providing a regime that would be likely to succeed in the Hong Kong market. Despite its continued belief that WVR is an important topic for Hong Kong, the Listing Committee considers that progress on a workable proposal for the listing of companies with WVR structures is not feasible in light of the SFC's objections. Although the SFC statement was directed at primary listings, after discussion with the SFC, the Listing Committee considers that it would also be relevant to secondary listings.

The Listing Committee's decision notes however that SEHK should continue to monitor developments in Hong Kong and abroad and that the issue of WVR may need to be reviewed in the future.

BACKGROUND

The Concept Paper

On 29 August 2014, the SEHK released a Concept Paper setting out relevant issues and considerations in order to promote discussion on whether companies with WVR structures should be allowed to list in Hong Kong. For a detailed discussion of the Concept Paper, please see our September 2014 newsletter.[3] The debate over WVR structures intensified when tech-giant Alibaba Group opted to list on the New York Stock Exchange. Although Alibaba initially expressed an interest in listing on the SEHK, its partnership model (which gives its founding shareholders the right to nominate a majority of the board) would have contravened the SEHK's one share, one vote (**OSOV**) principle. Much discussion focused on the importance of investor protection, a hallmark of the Hong Kong market with retail investor participation of over 40%, and the competitive position of SEHK compared to the US stock exchanges which allow the listing of companies with WVR structures.

1 HKEx. "Listing Committee Announces Way Forward on Weighted Voting Rights". 5 October 2015. Available at https://www.hkex.com.hk/eng/newsconsul/hkexnews/2015/151005news.htm.

2 SFC. "SFC statement on the SEHK's draft proposal on weighted voting rights". 25 June 2015. Available at http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69.

3 Charltons. "Hong Kong Stock Exchange Publishes Concept Paper on Weighted Voting Rights." September 2014. Available at http://www.charltonslaw.com/hkex-publishes-concept-paper-on-weighted-voting-rights/.

The Consultation Conclusions

The SEHK published its Consultation Conclusions on WVR[4] on 19 June 2015. These concluded that responses to the Concept Paper indicated support for a second stage consultation. The Consultation Conclusions included an outline of features of a draft proposal which the SEHK intended to refine through discussions with stakeholders before submitting it for formal consultation. The features of the draft proposal were aimed at ensuring that companies would only be allowed to list with WVR structures in certain limited circumstances and subject to a number of safeguards. It was the SEHK's intention that the one share, one vote principle should continue to apply in the vast majority of cases. The SEHK also provided the SFC with a more detailed version of the proposal for its consideration.

Key Features of the Draft Proposal

The principal features of SEHK's draft proposal were as follows:

a) *Restriction to New Listing Applicants*

WVR structures would only be allowed for new listing applicants: anti-avoidance language would be introduced to prevent existing listed issuers from circumventing the prohibition on them implementing WVR structures.

b) *High Expected Market Capitalisation*

In addition to meeting existing listing criteria, companies listing with a WVR structure would be required to have a very high expected market capitalisation.

c) *Test of "Enhanced Suitability"*

"Enhanced suitability" criteria identifying features SEHK would expect such companies to have related to the applicant's business and the contribution of the founder(s) would be set out in a Guidance Letter to supplement the existing Guidance Letter HKEx-GL68-13 on suitability for listing.

d) *Shareholding Restrictions*

Restrictions would be imposed on who can hold WVRs and the percentage shareholding interest such persons hold in the applicant prior to listing on the Exchange. Requirements would also be introduced for such persons to retain WVRs post-listing.

e) *Types of WVR*

Only WVR structures in the form of different classes of shares would be allowed to meet concerns expressed in relation to the operation of the Takeovers Code.

f) *Minimum Shareholding*

Those allowed to hold WVRs would have to maintain a minimum shareholding level for the rights to survive.

g) *Connected Persons*

Holders of WVRs would be "connected persons" under the Listing Rules.

h) *Differentiation*

WVR issuers would be differentiated by a stock name marker; would need to make prominent and on-going disclosure of the WVR structure; and would be required to make detailed disclosure of the voting activities of WVR holders.

i) *Enhanced Corporate Governance*

Issuers with a WVR structure would be required to adopt enhanced corporate governance measures in relation to (among others) independent non-executive directors, setting up a Corporate Governance Committee, the role of Compliance Adviser and shareholder communications.

j) *Secondary Listing and "Centre of Gravity"*

Subject to meeting the other requirements of the Joint Policy Statement on Listing Overseas Companies, companies with WVR structures would be allowed to secondary list on the Exchange even though their WVR structure would not meet the requirements for a primary listing for companies with such structures.

A limited waiver from the current "centre of gravity" test for Greater China companies that were primary listed on a Recognised Exchange before the date of the Consultation Conclusions with or without a WVR structure.

THE SFC STATEMENT

According to the SFC's statement of 25 June 2015, the Board of the SFC "unanimously concluded" that it did not support the SEHK draft proposal on WVR.

4 HKEx. "Consultation Conclusions to Concept Paper on Weighted Voting Rights". June 2015. Available at http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082cc.pdf.

It did not accept that restricting eligible applicants to those with a very high expected market capitalisation would protect investors. In particular, the size of a listed company would not ensure that a company would treat its shareholders fairly. Moreover, where an issuer with a large market capitalisation engages in corporate misconduct, this is likely to impact more investors and the Hong Kong market more significantly.

The SFC also expressed concern that "enhanced suitability" criteria (such as whether the applicant has certain unique features that are likely to provide a sustainable competitive advantage) would require the regulators to apply subjective and inherently vague criteria in assessing the eligibility of applicants for WVR structures. This would result in increased regulatory uncertainty, and could lead to inconsistent and unfair decision-making.

The draft proposal also envisaged that WVR structures would be limited to new listing applicants and that anti-avoidance measures would be introduced to prevent existing listed issuers from circumventing the prohibition on them implementing WVR structures. The SFC considered that this limitation may not prevent WVR structures becoming commonplace, which would harm Hong Kong's securities markets and reputation. The SFC questioned the effectiveness of the proposed anti-avoidance measures. To work, there would need to be provisions to stop listed issuers using arrangements such as spin-offs to get around the restriction. It also argued that merely limiting the number of WVR issuers would not be enough since those permitted to use WVR structures could acquire existing listed businesses or assets.

Another objection of the SFC was that there was no explanation as to how the numerous proposed safeguards and conditions could be continuously supervised, and what remedies would be available to regulators or public shareholders in the event of non-compliance with those safeguards and conditions.

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