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HKEx Consults on Proposed New Board for New Economy Companies

On 16 June 2017, the Hong Kong Stock Exchange (the **Exchange**) published its New Board Concept Paper[1] setting out proposals for the establishment of a New Board, separate from the Main Board and the GEM, to open Hong Kong's capital markets to a broader range of issuers. At the same time, the Exchange issued a separate but related Consultation Paper on the Review of the Growth Enterprise Market (**GEM**) and Changes to the GEM and Main Board Listing Rules[2] (the **GEM Consultation Paper**) which proposes to reposition the Main Board as a premier board for larger companies while GEM will continue to serve established SMEs. Both the Main Board and GEM will be subject to higher entry criteria and additional changes to the GEM Rules are proposed to address concerns relating to the quality and performance of GEM listing applicants and listed companies. Charltons has published a separate newsletter on the proposals set out in the GEM Consultation Paper. The Exchange has also published a set of Frequently Asked Questions[3] on the proposals.

The consultation period for both papers is two months and responses must be submitted on or before 18 August 2017.

The following is a summary of the proposals in the New Board Concept Paper.

1 http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017061.pdf
2 http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017062.pdf
3 http://www.hkex.com.hk/eng/newsconsul/hkexnews/2017/Documents/1706163news.pdf

The Rationale for the New Board

While Hong Kong has been the world's number one market for initial public offering (**IPO**) funds raised in five of the past eight years, the Exchange is conscious of the need to improve its competitiveness. According to data from the Exchange, companies from the financial and property sectors account for some 44% of total market capitalisation of the Hong Kong market, while New Economy companies make up only 3% of total market capitalisation, as compared with 60%, 47% and 15% for the NASDAQ, the New York Stock Exchange (the **NYSE**) and the London Stock Exchange (the **LSE**), respectively. The Exchange is concerned that the Hong Kong market's low exposure to companies in the fastest growing industries could cause stagnation and reduced investor interest.

The Hong Kong IPO market is also facing increasing competition from Mainland listing venues, including ChiNext and the National Equities Exchange and Quotation (also known as the "New Third Board"), launched in 2009 and 2012, respectively, to target emerging and innovative companies. Hong Kong has also faced competition from the US for listings of some of the most attractive Mainland companies from the information technology sector due in part to the fact that the US exchanges allow the listing of companies with weighted voting rights (**WVR**) structures, which are not permitted to list in Hong Kong. Major Chinese companies Alibaba Group Holding Limited, Baidu, Inc., JD.com, Inc. and Weibo Corp. are listed in New York. According to the Concept Paper, the Singapore Stock Exchange is considering allowing companies with WVR structures to list, while London has proposed allowing large international companies with WVR structures to list on an "international segment". If implemented, these proposals could provide further competition to Hong Kong as a listing venue. The Exchange's proposals would thus allow the listing of New Economy companies with WVR structures on the New Board and would also allow secondary listings of Mainland New Economy companies with WVR structures which have primary listings on the NYSE or NASDAQ.

The Proposals

The proposals set out in the New Board Concept Paper are intended to enhance Hong Kong's attractiveness to companies from New Economy sectors which have one or more of the following characteristics that currently prohibit them from listing in Hong Kong:

a) pre-profit companies;

b) companies with non-standard governance features such as WVR structures; and

c) Mainland Chinese companies that wish to list on the Exchange as a secondary listing venue.

The New Board is intended to provide a listing venue for New Economy companies in industries such as biotechnology, health care technology, internet and direct marketing retail, internet software and services, IT services, software, technology hardware, storage and peripherals. The definition of New Economy companies will be set out in guidelines prepared by the Exchange[4] and given that such definition is likely to evolve over time, the Listing Committee will have the ultimate discretion to determine whether an applicant is eligible for listing on the New Board on a principles-based approach.

The Exchange considers that a segmented approach to listing is the best way to attract a greater diversity of issuers to list in Hong Kong, while allowing it to tailor shareholder protection standards to the perceived risk level of each segment.

The New Board would thus be divided into two segments, New Board PREMIUM and New Board PRO.

New Board PRO

The key proposals are summarised below.

Target Issuers:	Earlier stage/ pre-profit New Economy companies that do not meet the financial or track record criteria for GEM or the Main Board and New Economy companies that are unable or unwilling to meet the equivalent shareholder protection requirements under the Joint Policy Statement Regarding the Listing of Overseas Companies jointly issued by the SFC and the Exchange in September 2013 (the **JPS**).
Eligible Investors:	Professional investors (as defined in the Securities and Futures Ordinance) only.
Track Record/ Financial Requirements:	No track record or minimum financial criteria, subject to a minimum market capitalisation at the time of listing of HK$200 million (which is the prevailing Main Board requirement).
Public Float at Listing:	Minimum of 25%.
Number of Shareholders:	Minimum of 100 shareholders at the time of listing.
Regulatory Approach:	A "lighter touch" approach to the suitability assessment of new applicants would be applied. The Exchange would not apply its existing suitability guidance set out in Guidance Letters GL68-13 and GL68-13A to applicants to New Board PRO. It would, however, retain the right to deny listing or apply additional or more stringent suitability criteria in appropriate circumstances.
Refusal of Listing:	The Exchange proposes to reserve a right to refuse an application for listing on New Board PRO if the Exchange has reason to believe that the applicant could meet the eligibility requirements for New Board PREMIUM, GEM or the Main Board and/or the applicant is unable to demonstrate that it has the characteristics of a New Economy company. This proposal is aimed at ensuring that only pre-profit companies with high growth potential or New Economy companies can apply to list on the New Board.

4 Exchange's FAQ on Proposed New Board and GEM Review, Question 13.

Overseas Issuers:	Regulatory cooperation measures will be required to be in place between the applicant's place of incorporation and place of central management and control (as defined by the JPS) and the SFC. No requirement to provide shareholder protection standards equivalent to those of Hong Kong under the JPS. The "centre of gravity" test under the JPS would not apply so that there would be no restriction on the secondary listing of Mainland enterprises.
WVR structures:	Permitted.
Listing Approval:	Listing applications would be vetted and approved by the Listing Department under delegated authority from the Listing Committee. The Listing Committee would be responsible for decisions on cancellations of listing and disciplinary matters.
Financial Adviser:	As New Board PRO will only be open to professional investors, it is proposed that the sponsor regime will not apply. Listing applications will be required instead to appoint a corporate finance adviser (licensed or registered for Regulated Activity Type 6) who would be expected to exercise their own professional judgement as to what investigations are appropriate for the applicant and to ensure that the Listing Document provides accurate and sufficient information to enable professional investors to make an informed investment decision.
Listing Document:	The prospectus requirements would not apply to New Board PRO since it is limited to professional investors. Listing applicants would only be expected to ensure that they prepare a Listing Document that provides accurate information sufficient to enable professional investors to make an informed investment decision.

New Board PREMIUM

The key proposals are summarised below.

Target Issuers:	New Economy Companies that meet the financial and track record requirements of the Main Board but are ineligible to list because they have non-standard governance structures.
Eligible Investors:	Retail as well as professional investors.
Track Record/ Financial Requirements:	Same as for the Main Board.
Public Float at Listing:	Minimum of 25% with an expected market value of HK$50 million (requirements will be the same as those of the Main Board from time to time).
Number of shareholders:	Minimum of 300 shareholders at the time of listing (requirements will be the same as those of the Main Board from time to time).
Regulatory Approach:	Similar to the Main Board.
Overseas Issuers:	Regulatory cooperation measures will be required to be in place between the SFC and the applicant's place of incorporation and place of central management and control (as defined by the JPS). Applicants will be required to provide shareholder protection standards equivalent to those of Hong Kong in accordance with the JPS. However, an exemption from them is proposed for companies already listed on the NYSE or NASDAQ. The "centre of gravity" test under the JPS would not apply so that there would be no restriction on the secondary listing of Mainland enterprises.

WVR structures:	Permitted.
Listing Approval:	Listing applications would be approved by the Listing Committee.
Sponsor Appointment:	The sponsor regime will apply.
Listing Document:	Listing documents will need to comply with the requirements for prospectuses under the Companies (Winding Up and Miscellaneous Provisions) Ordinance and the existing Main Board requirements for prospectuses.

Provisions Applicable to Both Segments

Continuing Obligations

Companies listed on both segments of the New Board would be required to comply with the continuing obligations applicable to Main Board-listed companies in relation to:

a) Timely disclosure of material information affecting the company's financial performance and of any material transactions;

b) Publication of annual and half-year financial statements under prescribed accounting standards within the deadlines specified in the Listing Rules;

c) Notifiable and connected party transaction rules;

d) Director suitability and independent non-executive director representation;

e) Requirement to appoint a company secretary to help advise on corporate governance matters;

f) General meetings;

g) Super-majority voting on certain fundamental matters such as changes to the rights of any class of shares, material changes to constitutive documents and voluntary winding up; and

h) Pre-emption rights for existing shareholders to protect investors from dilution.

Suspension and Delisting

The Exchange would suspend trading in the securities of a company listed on the New Board for a material breach of the New Board listing rules. Examples of circumstances in which the Exchange would suspend trading include:

- where a New Board-listed company fails to publish its financial information within the required deadlines; or

- the Exchange considers that the company or its business is no longer suitable for listing. According to the Concept Paper, the Exchange proposes to exercise this judgement only in extreme cases, for example where the company commits an act that adversely affects the reputation of the Exchange or the Hong Kong market that would not otherwise be grounds for suspension.

The Exchange would immediately cancel the listing of a company listed on the New Board PRO if it had been suspended for a continuous period of 90 days. In the case of a company listed on the New Board PREMIUM, the Exchange would cancel its listing after its suspension for a continuous period of 6 months. The Exchange would however retain the right to cancel a company's listing before the expiry of these prescribed periods and the right to cancel a listing immediately without any intervening suspension period, if it considers the company or its business to no longer be suitable for listing.

The Exchange is also requesting views on whether New Board-listed companies should be required to meet quantitative criteria (such as share price above a specified threshold) on a continuing basis. A company would be placed on a "watchlist" if it failed to satisfy these criteria over a specified period of time. The company could then be delisted if it remained unable to meet the criteria after a preset period on the "watchlist". Continuing quantitative criteria would allow poorly performing companies to be removed from the market and reduce the possibility of such companies becoming listed shells.

Additional Requirements for Companies Listing with WVR Structures

The Exchange is consulting on two alternative approaches to regulating companies with a WVR structure applying to list on the New Board. The first is a disclosure-based approach which would require companies to prominently disclose that they have a WVR structure and the risks associated with the structure. They could additionally be required to disclose other matters, such as the identities of WVR holders, their voting activities and the details of transfers of WVR. The alternative approach would be to impose mandatory safeguards for companies with WVR structures in addition to disclosure requirements. The safeguards imposed could vary according to whether the company was listed on PREMIUM or PRO. Examples of such safeguards include restrictions on the types of persons that can hold WVR, the minimum equity that they must hold in the company on an ongoing basis and restrictions on the transfer of WVR to other persons. Another possibility would be a requirement that the WVR structure fall away after a pre-determined period of time (i.e., a “sunset clause”).

Lack of Migration Mechanism

There would be no fast-track migration mechanism between the New Board and the Main Board or GEM, or from New Board PRO to New Board PREMIUM. If a company listed on New Board PRO wished to list on these platforms to attract retail investors, it would have to meet all the admission criteria and other listing requirements of the relevant board, which include the issuing of a prospectus. A requirement to raise additional capital via a public offer may also be imposed.

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