

## New Hong Kong Dual-Class and Biotech Companies Listing Regime

*Hong Kong Stock Exchange introduces new listing regime for pre-revenue biotech companies and innovative companies with weighted voting rights structures.*

### Summary

The Stock Exchange of Hong Kong Limited (the Exchange) published its consultation conclusions on a new listing regime for companies from emerging and innovative sectors (the Consultation Conclusion). The new rules, which broaden Hong Kong's listing regime, took effect on April 30, 2018. As part of the reforms, three new chapters have been added to the Main Board Listing Rules (the Listing Rules) and three new guidance letters have been published in order to:

- **HKEX-GL92-18:** Permit listings of biotech issuers that do not meet any of the Main Board financial eligibility tests
- **HKEX-GL93-18:** Permit listings of companies with weighted voting rights (WVR) structures
- **HKEX-GL94-18:** Establish a new concessionary secondary listing route for emerging and innovative sector companies that are primary listed on certain qualifying stock exchanges and wish to secondary list in Hong Kong

### Biotech Companies

#### Qualifications

Under the new listing regime, biotech companies that do not meet any of the Listing Rules' three financial eligibility tests — namely, the profit test, the market capitalization / revenue / cash flow test, or the market capitalization / revenue test (the Financial Eligibility Tests) — could list under a new Chapter 18A of the Listing Rules if they satisfy the following requirements:

- **Eligibility and Suitability:** The applicant must demonstrate eligibility and suitability for listing as a biotech company to the Exchange's satisfaction.
- **Expected Market Capitalization:** Biotech company applicants must have a minimum expected market capitalization at the time of listing of HK\$1.5 billion.

- **Track Record:** A biotech company applicant must also have operated in its current line of business for at least two financial years prior to listing, under substantially the same management.
- **Working Capital Requirements:** The applicant must have available working capital to cover at least 125% of the group's costs for at least the next 12 months (after taking into account the proceeds of the new applicant's initial listing).

In assessing suitability for listing as a biotech company under Chapter 18A of the Listing Rules, the Exchange has issued a new guidance letter (HKEX-GL92-18) outlining certain features generally accepted as indications of suitability for a biotech company listing.

- The biotech company must have developed at least one core product beyond the concept stage. A core product is a biotech product, process, or technology that laws, rules, or regulations require a competent authority to approve based on data derived from clinical trials, before being marketed and sold in the market regulated by the competent authority — namely, the US Food and Drug Administration (FDA), the China Food and Drug Administration (CFDA), and the European Medicines Agency. The Exchange would consider a core product to have been developed beyond the concept stage if it has met the developmental milestones specified for the relevant product type — namely, pharmaceutical (small molecule drugs), biologics, medical devices (including diagnostics), and other biotech products.
- The biotech company must have been primarily engaged in research and development (R&D) for the purposes of developing its core product(s).
- The biotech company must have been engaged with the R&D of its core product(s) for a minimum of 12 months prior to listing (and, in the case of a core product that is in-licensed or acquired from third parties, the applicant must be able to demonstrate R&D progress since the in-licensing/acquisition).
- The biotech company must have identified raising finance for R&D to bring its core product(s) to commercialization as the primary reason for listing.
- The biotech company must have registered patent(s), patent application(s), and/or intellectual property in relation to its core product(s).
- If the applicant is engaged in the R&D of pharmaceutical (small molecule drugs) products or biologic products, it must demonstrate that it has a pipeline of those potential products.
- The biotech company must have previously received “meaningful third-party investment” (more than just a token investment) from at least one “sophisticated investor” at least six months before the date of the proposed listing, which must remain at the initial public offering (IPO). The Exchange will consider the sophistication of an investor by reference to factors such as net assets or assets under management, relevant investment experience, and the investor's knowledge and expertise in the relevant field.

Further to the Exchange's consultation paper (the Consultation Paper), published in February 2018, the Exchange has provided additional guidance on the definitions of sophisticated investor and meaningful investment. The Exchange would generally consider any of the following as a sophisticated investor:

- A dedicated healthcare or biotech fund, or an established fund with a division/department that specializes in or focuses on biopharmaceutical sector investments

- A major pharmaceutical/healthcare company
- A venture capital fund of a major pharmaceutical/healthcare company
- An investor, investment fund, or financial institution with a minimum assets under management of HK\$1 billion

As an indicative benchmark, the following investment amounts will generally be considered as a meaningful investment:

- Applicant with market capitalization of HK\$1.5 billion to HK\$3 billion, an investment of no less than 5% of the applicant's issued share capital at the time of listing
- Applicant with market capitalization of HK\$3 billion to HK\$8 billion, an investment of no less than 3% of the applicant's issued share capital at the time of listing
- Applicant with market capitalization of more than HK\$8 billion, an investment of no less than 1% of the applicant's issued share capital at the time of listing

However, the Exchange will assess whether an investor is a sophisticated investor and whether such investment is a meaningful investment on a case by case basis.

### Enhanced Safeguards

A biotech company is subject to the following requirements if its listing as a biotech company is approved by the Exchange:

- **Enhanced Disclosure Requirements:** A biotech company applying for a listing will be required to provide prominent warning statements and enhanced risk disclosures.
- **Cornerstone Investor:** The applicant must ensure that a portion of the total number of issued shares with a market capitalization of at least HK\$375 million are held by the public (excluding any shares allocated to cornerstone investor or subscribed by existing shareholders) at the time of its initial listing. As long as this requirement is met, cornerstone investments and subscriptions by existing shareholders could be included in the determination of a biotech company's public float in accordance with Rule 8.24 of the Listing Rules.
- **Material Change of Business:** A biotech company listed under the new listing regime must not effect any acquisition, disposal, or any other transaction or arrangement that would result in a fundamental change to its principal business without the Exchange's prior consent.

### Biotech Advisory Panel

Given the specialized nature of the biotech sector, the Exchange will assemble a panel of industry experts to form a biotech advisory panel. The Exchange will consult this panel on an individual and as needed basis to assist them in reviewing listing applications and assessing biotech company applicants' suitability.

## Amendments to the Consultation Paper's Original Proposal

The new listing regime for biotech companies does not materially deviate from the original proposal in the Consultation Paper; however, the Exchange has amended and/or clarified certain points, which include (among others):

- Providing further guidance on the definitions of sophisticated investor and meaningful investment, as discussed above
- Providing for more flexibility regarding the exclusion of cornerstone investments and subscriptions by existing shareholders from the determination of public float, as discussed above
- Clarifying that the accountants' report of a biotech company only needs to cover two financial years, and that a biotech company must apply for certificate of exemption from the relevant disclosure requirements under the Third Schedule of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong)
- Requiring further disclosure on measures to retain key personnel and disclosure relating to the capacity of biologics

## Companies With WVR Structure

### Qualifications

Under the new listing regime set out in a new Chapter 8A of the Listing Rules, companies with a WVR structure may seek listing on the Exchange if, in addition to satisfying the Financial Eligibility Tests, an applicant satisfies one of the following conditions:

- A market capitalization of at least HK\$40 billion at the time of listing
- A market capitalization of at least HK\$10 billion at the time of listing, and a revenue of at least HK\$1 billion for the most recent audited financial year

The Exchange would also account for the following factors when assessing whether an applicant is eligible and suitable for listing with a WVR structure:

- **Nature of the Company:** The applicant must be an innovative company, for example, (i) its success is demonstrated to be attributable to the application of new technologies, innovations, and/or a new business model, to the company's core business; (ii) R&D is a significant contributor to its expected value and constitutes a major activity and expense; (iii) its success is demonstrated to be attributable to its unique features and/or intellectual property; and/or (iv) it has an outsized market capitalization / intangible asset value relative to its tangible asset value.
- **Success of the Company:** The applicant must demonstrate a track record of high business growth that is expected to continue.
- **Contribution of WVR Beneficiaries:** Each WVR beneficiary must have been materially responsible for the growth of the business, by way of the WVR beneficiary's skills, knowledge, and/or strategic direction in circumstances and that the value of the company is largely attributable or attached to intangible human capital.

- **Role of WVR Beneficiaries:** Each WVR beneficiary must be (i) an individual who has an active executive role within the business, and who has contributed to a material extent to the ongoing growth of the business; and (ii) a director of the issuer at the time of listing.
- **External Validation:** The applicant must have previously received meaningful third-party investment (being more than just a token investment) from at least one sophisticated investor (which must remain at IPO). Such sophisticated investors will be required to retain an aggregate 50% of their investments at the time of listing for a period of at least six months post-IPO.

Notably, however, the demonstration of any or all of the characteristics above may not of itself ensure an applicant's suitability to list with a WVR structure.

### Major Restrictions on the WVR Structure

The new listing regime imposed the following restrictions on the WVR structure:

- Only new applicants can adopt a WVR structure.
- The WVR structure must attach WVRs only to a class of an issuer's equity securities.
- The WVR structure must confer on a WVR beneficiary enhanced voting power on resolutions tabled at the issuer's general meetings only. Rights in other aspects must otherwise be the same as the rights attached to the ordinary shares.
- The issuer must not seek a listing of a class of shares carrying WVRs.
- Non-WVR shareholders must be entitled to cast at least 10% of the votes that are eligible to be cast on resolutions at the listed issuer's general meetings.
- The class of shares conferring WVRs must not carry voting power that is more than 10 times of that of the ordinary shares.
- At the time of listing, the beneficiaries of WVRs must beneficially own collectively at least 10% of the underlying economic interest in the applicant's total issued share capital. The Exchange may accept a lower threshold if the expected market capitalization of the applicant is large (e.g., more than HK\$80 billion).
- A listed issuer must not increase the proportion of shares that carry WVRs above the proportion in issue at the time of listing (including by way of share repurchase or if non-WVR proportion in a pro rata offering of new shares is not entirely taken up).
- Terms of a class of shares carrying WVRs must not be changed to increase the WVRs attached to such class after the listing.
- Any conversion of shares with WVRs into ordinary shares must be on a 1:1 ratio, and prior approval from the Exchange must be sought for the listing of any shares that are issuable upon conversion of shares carrying WVRs.

## Termination of WVRs

The beneficiary's WVRs shall cease if, at any time after the listing, the beneficiary is (i) deceased; (ii) no longer a member of the board of directors of the issuer; (iii) deemed by the Exchange to be incapacitated for the purpose of performing duties as a director; or (iv) deemed by the Exchange to no longer meet the requirements of director set out in the Listing Rules.

The WVRs attached to a beneficiary's shares shall also cease upon transfer of beneficial ownership of, economic interest in, or the control over the voting rights attached to, such shares to another person. However, a limited partnership, trust, private company, or other vehicle may hold shares carrying WVRs on behalf of a beneficiary provided that such arrangement does not result in a circumvention of the foregoing.

## Corporate Governance

The following additional corporate governance measures shall be observed by issuers with a WVR structure:

- Non-WVR shareholders carrying no more than 10% of the voting rights on a one-vote-per-share basis in the share capital of the listed issuer shall be able to convene an extraordinary general meeting and add resolutions to the meeting agenda.
- Any resolutions approving the following matters shall be voted on a one-vote-per-share basis: (i) changes to the constitutional documents; (ii) variation of rights attached to any class of shares; (iii) appointment or removal of independent non-executive directors (INEDs); (iv) appointment or removal of auditors; and (v) voluntary winding-up of the listed issuer.
- The listed issuer must establish a corporate governance committee comprised entirely of INEDs.
- An issuer with a WVR structure shall appoint a compliance adviser on a permanent basis commencing on the date of listing.
- The directors, senior management, and company secretary of the listed issuer shall have undertaken training on rules regarding WVR structure and risks associated with a WVR structure.

## Interaction With PRC Restrictions on Foreign Ownership

The Exchange received comments and inquiries from stakeholders with respect to the interaction between WVR structures and People's Republic of China (PRC) restrictions on foreign ownership. Notably, the Ministry of Commerce of the PRC (MOFCOM) published a consultation draft of the PRC Foreign Investment Law in January 2015. If the draft PRC Foreign Investment Law were to come into effect, companies under the control, or de facto control, of a Chinese citizen would not be subject to foreign investment restrictions. As such, Chinese citizens could potentially use WVRs to demonstrate that they have de facto control of a listed issuer.

However, as the WVRs permitted under the current listing regime could not exist indefinitely as a result of the requirement that they fall away in certain circumstances, including the death or incapacity of the WVR beneficiary, the WVR beneficiary may lose de facto control of the listed issuer upon occurrence of any such event, which may potentially result in a contravention of the foreign investment restrictions set out in the PRC Foreign Investment Law. The Exchange had in the past accepted disclosure of the relevant risks associated with the PRC Foreign Investment Law without requiring the issuer to specify how compliance with the draft PRC Foreign Investment Law will be achieved if it is promulgated. This approach will

continue to be adopted by the Exchange with respect to applicants with the WVR structure until further guidance is published. Accordingly, applicants in an industry subject to foreign ownership restrictions will be required to disclose clearly the risks that the WVRs may fall away and that, consequently, they may not be able to comply with the PRC Foreign Investment Law.

### **Mandatory General Offer**

The Exchange clarified that a mandatory general offer would not normally be required in the event that a shareholder's voting rights in an issuer increased solely due to the WVRs attached to WVR shares falling away — if the relevant person is independent of the event that has led to the WVRs falling away — in either of the following instances:

- A shareholder's voting rights increase more than 30%
- A shareholder's voting rights increase by more than 2%, in the case of a shareholder holding at least 30% — but less than 50% — of the voting rights

### **Amendments to the Original Proposal in the Consultation Paper**

The major amendments made to the original proposal set out in the Consultation Paper after the Exchange considered submissions and comments from stakeholders, and their respective underlying rationale, include:

- **Removal of Maximum Shareholding of WVR Beneficiaries of 50% at the Time of Listing:** The original proposal intends to limit the use of WVRs to individuals that would otherwise not be able to exercise control over the listing applicant after listing. However, the Exchange acknowledged that some issuers may anticipate having significant post-listing funding needs or the need to set aside a significant proportion of shares for employee incentive schemes, which in turn give rise to legitimate commercial reasons for allowing a company to list with WVR beneficiary/beneficiaries whose shareholdings exceed 50% of the underlying economic interest in the issue at listing.
- **New Disclosure Requirements on Circumstances When WVRs Will Cease:** The Exchange concurs that an issuer with a WVR structure should inform investors of the circumstances under which the WVRs would cease. Accordingly, an issuer with a WVR structure is required to disclose in its listing documents, annual reports, and interim reports all the circumstances in which the WVRs attached to its shares will cease.
- **Composition of Corporate Governance Committee:** The composition of the corporate governance committee's members has been amended from having a majority representation of INEDs to being composed entirely of INEDs, in order to address concerns on the sufficiency of corporate governance safeguards raised by stakeholders.
- **Enhancement of Responsibilities of Corporate Governance Committee:** With a view to further enhance corporate governance safeguards, the corporate governance committee's terms of reference shall also include:
  - (i) Providing a recommendation to the board of the issuer on any matter in which there is a potential conflict of interest between the issuer, a subsidiary of the issuer, and/or shareholders of the issuer (considered as a group), on the one hand, and any beneficiary of WVRs, on the other hand

- (ii) Providing a recommendation to the board of the issuer on any transaction between the issuer and/or a subsidiary of the issuer, on the one hand, and any beneficiary of WVRs, on the other hand
- (iii) Providing a recommendation to the board of the issuer on the appointment or removal of a compliance adviser
- (iv) Disclosing, on a comply or explain basis, its recommendations to the board of the issuer in relation to matters set out in (i) to (iii) above in the report on the corporate governance committee's work that is published on a semi-annual basis

## Next Steps

The Exchange has received feedback from stakeholders that corporate entities should also be able to benefit from WVRs. Such proposal would mark a significant new development. Therefore, the Exchange will launch a separate consultation by July 31, 2018 to propose requirements and safeguards applicable to corporate WVR beneficiaries.

Initial applications by WVR applicants will be considered on a case-by-case basis with a high degree of subjectivity on the part of the Exchange. The Exchange is taking this approach because it has been inclined to avoid establishing a bright line test for certain aspects of the new listing regime for WVR applicants and because it intends to provide further guidance and clarity as it gains more experience. Developments in other overseas stock exchanges pertaining to WVR issuers are also likely to influence the Hong Kong listing regime, as the Exchange has repeatedly expressed its intention to maintain Hong Kong's competitiveness as a listing venue.

## Secondary Listing Regime

A new Chapter 19C has been added to the Listing Rules. In addition, the 2013 Securities and Futures Commission (SFC) and Exchange Joint Policy Statement regarding the Listing of Overseas Companies (2013 JPS) has been amended to create a new concessionary route to secondary listing for companies primary listed on a qualifying exchange (*i.e.*, the New York Stock Exchange, NASDAQ, or the "premium listing" segment of the London Stock Exchange's Main Market) (qualifying issuers).

## Qualifying Issuer

A qualifying issuer must meet all of the following requirements:

- A qualifying issuer must be eligible and suitable for listing. A qualifying issuer would normally be considered suitable for secondary listing if it is an innovative company, as described previously.
- A qualifying issuer must have a good record of compliance for at least two years on a qualifying exchange.
- A qualifying issuer must have an expected market capitalization of at least HK\$10 billion at the time of secondary listing in Hong Kong. A secondary listing applicant that (i) has a WVR structure; and/or (ii) is a Greater China issuer (*i.e.*, an issuer with a "centre of gravity" in Greater China), will also be required to have at least HK\$1 billion of revenue in its most recent audited financial year if it has an expected market capitalization of less than HK\$40 billion at the time of its secondary listing in Hong Kong.



To facilitate such secondary listing, Practice Note 22 has been modified so that a new applicant for a secondary listing under the new listing regime can file its application proof confidentially. In this way, the issuer would be able to preserve a “safe harbour” from certain disclosure requirements in its jurisdiction of primary listing.

### **Automatic Waivers**

The Exchange has codified the waivers in the Listing Rules that are currently automatically granted to eligible companies (for example, requirements regarding connected transactions, notifiable transactions, and the Corporate Governance Code) with, or seeking, a secondary listing under the 2013 JPS. Qualifying issuers seeking a secondary listing under the new concessionary route would have the benefit of these codified waivers.

### **Equivalence Requirements**

Non-Greater China issuers (*i.e.*, issuers that do not have their “centre of gravity” in Greater China) and grandfathered Greater China issuers (*i.e.*, Greater China issuers with a primary listing on a qualifying exchange on or before December 15, 2017) must demonstrate, to the Hong Kong Stock Exchange’s satisfaction, how key shareholder protection standards as set out in the 2013 JPS are met. Accordingly, they must demonstrate to the Exchange’s satisfaction, how their constitutional documents, as well as how the domestic laws, rules, and regulations to which they are subject, provide the key shareholder protection standards.

### **VIE Structures**

Grandfathered Greater China issuers will be able to secondary list with their existing variable interest entity (VIE) structure. For such companies:

- The Exchange will require a PRC legal opinion confirming that the VIE structure complies with PRC laws, rules, and regulations.
- The issuer must meet VIE Guidance disclosure requirements.

### **WVR Companies**

Qualifying issuers seeking a secondary listing under the new concessionary route with a WVR structure will be required to meet the eligibility and suitability criteria applicable to WVR companies and the market capitalization requirement for a WVR company as described above. Non-Greater China issuers and grandfathered Greater China issuers will be able to secondary list with their existing WVR structures and will not have to comply with the proposed ongoing WVR safeguards except for the enhanced disclosure requirements.

### **Non-Grandfathered Greater China Issuers**

Greater China issuers that are primary listed on a qualifying exchange after December 15, 2017 (the date of the New Board Concept Paper Conclusions) will not be granted the concessions with regards to the equivalence requirement, VIE structures, and WVR structures. These non-grandfathered Greater China issuers must vary their constitutional documents to meet the key shareholder protection standards. Further, if they have a WVR structure, the structure must conform to all primary listing requirements, including all ongoing WVR safeguards.

## Migration of the Bulk of Trading to Hong Kong

If the bulk of trading in the shares of an issuer migrates to Hong Kong from the qualifying exchange on a permanent basis (meaning 55% or more of the total worldwide trading volume (by dollar value) of those shares (including the trading volume in depository receipts issued on those shares) over the issuer's most recent financial year on the Exchange's market), the codified waivers granted to Greater China issuers under the new concessionary route will no longer apply. These companies would be treated as having a dual-primary listings in Hong Kong and the qualifying exchange and would, on a case-by-case basis, be granted only waivers that are commonly granted to dual-primary listed issuers. The Codes on Takeovers and Mergers and Share Buy-backs (the Takeovers Code) will not apply to secondary listing of grandfathered Greater China issuers, but if the bulk of trading moves to Hong Kong and the issuer be treated as a dual-primary listed company in Hong Kong, the Takeovers Code would apply at that point.

As a result, following such migration:

- Greater China issuers that have continuing transactions in place with third parties on the basis that the rules on notifiable/connected transactions did not apply to a secondary listed issuer, will be exempted from having to comply with such Listing Rules for a period of three years from the date on which the issuer is treated as having a dual-primary listing.
- Non-Greater China issuers or grandfathered Greater China issuers with a WVR structure would not need to comply with the WVR safeguards applicable to primary listings other than WVR safeguards that are disclosure requirements.
- Non-Greater China issuers or grandfathered Greater China issuers with VIE structures would not be required to amend their VIE structures.
- A 12-month grace period will be granted for such issuers to comply with the applicable requirements.

## Conclusion

Prospective listing applicants under the new listing regime and their sponsor(s) may now submit formal pre-IPO inquiries regarding the interpretation of the Listing Rules in connection with the new listing regime, as well as their application to the prospective listing applicant's circumstances. A formal application for listing under the new regime can be submitted beginning on April 30, 2018. Prospective listing applicants under the new listing regime are encouraged to consult their legal advisers as soon as possible to consider their eligibility to be listed under the new listing regime. This new listing regime will likely attract more prospective listing applicants to the Exchange and will likely increase the competitiveness of the Exchange in order to remain a top listing venue.

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