Re-positioning Hong Kong's Stock Markets

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Background

On December 15, 2017, Hong Kong Exchanges and Clearing Limited (HKEX) announced the conclusions to its New Board Concept Paper (Conclusions). HKEX proposed to reform the existing Listing Rules and broaden listing standards to provide more favorable conditions for different types of enterprises, especially those from new economy and innovative industries, to list in Hong Kong. Hong Kong has decided to take a big step forward as a global financial center adjacent to Mainland China and will welcome innovative, new economy companies that use non-standard share structures and pre-revenue companies from the biotech sector.

HKEX has determined to proceed to expand the existing listing regime by introducing two new chapters to the Main Board Listing Rules to allow the listing of (a) biotech issuers which are pre-profit / pre-revenue; and (b) issuers from emerging and innovative sectors that have weighted voting rights (WVR) structures, subject to additional disclosure and safeguards. HKEX also proposes to modify the existing Main Board Listing Rules in relation to overseas companies (and make consequential changes to the Joint Policy Statement Regarding the Listing of Overseas Companies jointly issued by the Securities and Futures Commission and The Stock Exchange of Hong Kong Limited in September 2013) to create a new secondary listing route to attract innovative issuers that are primary listed on a qualifying exchange.

HKEX's New Emphasis on Emerging and Innovative Industries

The Conclusions place a heavy emphasis on attracting high-growth companies from emerging and innovative industries to Hong Kong for listing. High growth companies, in new economy and innovative industries, have the following features:

(1) The company's success is demonstrated to be attributable to the application of (a) new technologies; (b) new innovations; and/or (c) new business model to the company's core business, which also serves to differentiate the company from existing listed companies.

(2) Research and development is a significant contributor of expected value and constitutes a major activity and expense.

(3) The company's success is demonstrated to be attributable to unique features or intellectual property.

(4) The company has an outsized market capitalization / intangible asset value relative to its tangible asset value.

These criteria play a role in judging whether a company is one that is part of the new economy industry. According to the Conclusions, the framework for listing pre-revenue companies will be limited initially to biotech companies. However, given the rapid growth of new economy companies and the plethora of industries involved, it is believed that HKEX will continue to update the standards and requirements of the Listing Rules to keep on attracting a broader spectrum of quality companies to list in Hong Kong by incorporating the experience of new economy listings.

Companies with WVR structures would be required to have a minimum expected market capitalization of HK$10 billion and, if below HK$40 billion of market capitalization, would need to meet a higher revenue test of HK$1 billion in the full financial year before listing.

The Rationale for Allowing Pre-Profit Biotech Companies to List in Hong Kong

With regards to pre-profit new economy companies, HKEX will initially only accept applications to list from biotech companies. Biotech companies refer to companies that are engaged in the research and development, application and commercialization of products, processes or technologies in the biotech sphere. HKEX will allow pre-profit biotech companies to list in Hong Kong for the following reasons:

(1) Its success is attributable to patents or other intellectual property rights which involve high-technology content.

(2) Most biotech companies are strictly regulated, such as pharmaceutical companies. Their operations and development must follow the standards and systems established by regulators to identify development progress. Therefore, even if a company is pre-profit, it can still provide investors with frame of reference to identify to value of companies.

(3) The business development of biotech companies relies heavily on research and development capabilities, which requires substantial capital. Therefore, allowing pre-profit biotech companies that have potential to list in Hong Kong can enable them to solve the problem of capital shortage and develop rapidly.

At the same time, given that such biotech companies are pre-profit and that their future development is yet to be secure, HKEX will require that such companies enhance the disclosure of information in their listing applications to ensure that investors are fully aware of their business development and other related risks.

In view of this, the permission of pre-profit biotech companies to list in Hong Kong is based on a certain degree of rationality, but also on the hope that the pilot program will be able to broaden access to the markets and acceptance of new concepts by investors and market professionals.

Secondly, HKEX has also made detailed provisions regarding the scope of qualified pre-profit biotech applicants.

(1) **Company Types**

The types of biotech companies currently expected to apply include (a) pharmaceuticals, (b) biotechnology and life sciences, (c) medical equipment and supplies, and (d) medical technology companies, among others.

(2) **Market Capitalization Requirements**

The expected minimum market value of the companies when they are listed should reach HK$1.5 billion. Therefore, only relatively mature companies can apply for listing in Hong Kong via this route, and must comply with strict disclosure requirements for protection of the interests of investors.

Amendments to the Listing Rules

HKEX will not set up an independent board for new economy companies, but instead will introduce two additional chapters to the current Main Board Listing Rules to govern the listing of biotech companies in Hong Kong.

The rationale of this approach is to keep the listed companies concentrated on an existing board, allowing HKEX to strengthen the existing Main Board as opposed to introducing another board. This approach can avoid the widening spread of investors in different boards, which is beneficial for the neutral concentration of investment. Furthermore, building upon the existing Listing Rules, the listing of biotech companies will be subject to the same basic conditions as the existing Main Board listed companies, thereby ensuring the uniformity of listing application criteria.

A Comparative Note on FCA's Recent Stock Market Re-positioning

The Financial Conduct Authority (FCA) of the UK launched a consultation last July to create a new listing category for sovereign controlled companies. The rationale for this new listing category is to recognize the need to have different rules regarding connected transactions, reliance, competition, takeovers, etc. for such companies in order to attract relevant listing candidates, so that the listing regime and the whole society can effectively reap benefits from their listing in the UK.

Andrew Bailey, FCA's Chief Executive, said: "Regulatory protections for investors lie at the core of the listing regime. However, it is important that these protections remain well-targeted. Refining the listing regime in this way would make UK markets more accessible whilst ensuring that the protections afforded by our premium listing regime are focused and proportionate."

Conclusion

There are ways to maintain adequate shareholders' protection while facilitating the listing of significant companies that are shaping our future world. Catching the market opportunities in a thoughtful manner that maintains the basic integrity and disclosure of the markets will benefit all stakeholders. A company with large market capitalization and trading volume can produce significant revenue in the form of stamp duty on trading of shares to a society and bring multi-faceted developments towards its well-being. A well-off society will in turn have more resources to build, maintain and enforce systems that protect investors and promote decent developments of listed companies.

The Conclusions provide an opportunity for new economy companies to list in Hong Kong. In particular, currently biotech companies in the region are experiencing rapid development. Through the provisions introduced in the Conclusions, Hong Kong can broaden the listing channels of its capital markets and enhance Hong Kong's position and role as a global financial center. With the experience gained from this brave change, Hong Kong's capital markets will be able to build upon its dynamic and adaptive characteristics and innovate with the emerging global industries so as to further strengthen Hong Kong's international competitiveness.

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