ACUMINOUS

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WEIGHTED VOTING RIGHT CONSULTATION CONCLUSION

On 30 October 2020, The Stock Exchange of Hong Kong Limited (the "**Exchange**") has published its conclusion to its consultation on the corporate weighted voting rights ("**WVR**") beneficiaries (the "**Consultation**"). In this issue, we will go through the key results of the Consultation and the relevant decision of the Exchange.

Executive Summary

The Exchange received responses to the Consultation paper from a broad range of respondents, among which, a majority supported in principle permitting corporate entities to benefit from WVR, and the Exchange has accordingly made the following decisions:-

Withholding the Proposal – In spite of the positive response, the Exchange have decided to give more time for the market to develop a better understanding of the current regime.

Secondary listings by Qualifying Corporate WVR Issuers – The Exchange decided to treat Greater China Issuers that are controlled by corporate WVR beneficiaries and primary listed on a Qualifying Exchange on or before 30 October 2020 in the same manner as Grandfathered Greater China Issuers for the purposes of Chapter 19C of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "**Listing Rules**").

Key proposals of the Exchange

Regarding the proposals to extend its current WVR regime to permit corporates to benefit from WVR, the Exchange has proposed a series of safeguards to cope with the potential issues arising from WVR. Set out below are the key proposed safeguards from the Exchange:-

- **Pre-listing 10% Economic Interest** – A corporate WVR beneficiary should (a) hold at least a 10% economic interest; and (b) be materially involved in the management or business of the listing applicant for at least two financial years before the date of its application for listing.

- **30% threshold & single largest shareholder requirement** – A corporate WVR beneficiary own at least a 30% economic interest in the listing applicant and be the single largest shareholder at listing.

- **Exception from requiring share issues on a pre-emptive basis without shareholder approval** – To introduce an exception in the existing Listing Rules to permit a non-pre-emptive share issuance to a corporate WVR beneficiary without shareholder approval solely for the purpose and to the extent necessary to enable it to comply with the ongoing 30% economic interest requirement so long as certain conditions are satisfied.

- **Maximum voting ratio of WVR shares for Corporate WVR beneficiary** – To set a maximum voting ratio of WVR shares for Corporate WVR beneficiary at no more than five times the voting power of ordinary shares.

- **Ecosystem requirement** – A corporate WVR beneficiary should be required to demonstrate its contribution through the inclusion of the listing applicant in its ecosystem in order to benefit from WVR.

- **Size of corporate WVR beneficiary** – A corporate WVR beneficiary should have a minimum market capitalisation requirement of HK$200 billion at the time of listing.

- **Imposition of a time-defined sunset period on corporate WVR** – WVR of a corporate WVR beneficiary should be subject to a time-defined sunset, with an initial sunset period of not more than 10 years.

- **Conversion of Corporate WVR Shares upon the fall-away of Individual WVR** – Upon any individual WVR fall-away due to "event-based" sunset, the corporate WVR beneficiary would not be required to convert part of its WVR shares into ordinary shares. This would mean that the corporate WVR beneficiary would benefit from a larger voting power percentage after any individual WVR fall-away.

View of respondents who support corporates WVR

A majority of the respondents supported the proposal to expand the existing WVR regime to enable corporate entitles to benefit from WVR (the "**Supportive Respondents**"). However, there are very diverse views and expectations as to how the proposed regime would operate in practice and whether (and if so what) modifications were required for it to operate as intended. Among the above key proposals from the Exchange, only one proposal obtained support from more than half of the Supportive Respondents. Besides, for most of the proposals, there are around one-third of the Supportive Respondents did not express any views.

Views of respondents who oppose corporate WVR

Pursuant to the results of the Consultation, less than one-third of respondents rejected the proposal based on the concerns set out below:-

- **Entrenchment of management –** The introduction of corporate WVRs may hinder the removal of under-performing management by shareholders and expose shareholders to significant disenfranchisement and lack of control over key company matters as well as the associated risks of management entrenchment.

- **Misalignment of interests –** The controlling shareholders of corporate WVR beneficiaries could be in a position to exercise majority voting power in WVR issuers with only a small and indirect economic interest in the issuers, leading to a greater risk of a misalignment between their interests with the interests of the WVR issuer.

- **Exchange of WVR is possible** – as the control of a corporate WVR beneficiary can change, the WVRs of the corporate beneficiary would effectively become tradeable and be used by someone who had not made a commensurate non-economic contribution to the development of the issuer.

- **Lack of fiduciary duties –** A corporate is not a natural person and therefore does not owe fiduciary duties to an issuer in the same way as an individual shareholder.

- **Corporate WVR may exist indefinitely** – Unlike an individual WVR beneficiary, a corporate does not have a natural lifespan. The WVR of the corporate entity can exist in perpetuity even with change in ownership or after the corporate has ceased contributing to the development of the issuer.

- **No safeguards are sufficient –** The safeguards proposed in the Consultation paper only provided a limited degree of protection of minority shareholders. As it is nearly impossible to cover all the scenarios where minority shareholders may be disadvantaged, no safeguards may adequately mitigate against the risks of corporate WVR structures.

- **Reputational risk** – Multiple voting rights were incompatible with the principle of fair treatment of all shareholders and would dilute minority voting rights. The extension of the WVR franchise to corporate holders may result in the accumulation of "structural corporate governance deficits" in the Hong Kong listed market and run counter to the broad global movement of empowering and requiring institutional investors to conduct stewardship of public listed assets, which may eventually lead to further deterioration of governance standards and practices, thus weakening investor trust in the Hong Kong market and making it less attractive for both investors and issuers.

Decision of the Exchange

While a majority of respondents agree in principle that corporate WVR beneficiaries should be permitted, given the diverse views and expectations on the proposed regime, the Exchange has decided to give more time for the market to develop a better understanding of Hong Kong's regulatory approach towards regulating listed companies with WVR structures and their controllers, and for regulators to monitor that the existing Chapter 8A regime operates as intended, which will help to inform any future amendments.

Meanwhile, regarding secondary listing of issuers controlled by corporate WVR beneficiaries as at 30 October 2020, the Exchange decided to extend the coverage of qualifying corporate WVR issuers ("**Qualifying Corporate WVR Issuers**") from issuers with a centre of gravity in Greater China (as defined under Chapter 19C of the Listing Rules) ("**Greater China Issuers**") primary listed on the New York Stock Exchange (NYSE), Nasdaq or the "Premium Listing" segment of the London Stock Exchange's Main Marketa (the "**Qualifying Exchanges**") on or before 15 December 2017 ("**Grandfathered Greater China Issuers**") to Greater China Issuers primary listed on a Qualifying Exchange on or before 30 October 2020.

Qualifying Corporate WVR Issuers will be permitted to secondary list in Hong Kong with their existing WVR structures in place, regardless of whether they meet the requirements under Chapter 8A of the Listing Rules that apply to the WVR structure of a primary listing applicant, subject to meeting prescribed eligibility and suitability requirements under Chapter 19C of the Listing Rules.

A listing applicant will be regarded as "controlled by corporate WVR beneficiaries" if a single corporate WVR holder (or group of corporate WVR holders acting in concert) holds the largest share of the voting power in the listing applicant which amounts to at least 30% of the listing applicant's total voting power.

A Greater China Issuer applying for listing under this arrangement will have to comply with all other requirements of Chapter 19C of the Listing Rules and must demonstrate to the Exchange that: (i) it has a market capitalisation of at least HK$40 billion, or at least HK$10 billion with at least HK$1 billion of revenue for its most recent audited financial year; (ii) it is an "innovative company"; and (iii) domestic laws, rules and regulations to which it is subject and its constitutional documents, in combination, provide the shareholder protection standards specified in the Listing Rules.

Under Rule 19C.11 of the Listing Rules, Qualifying Corporate WVR Issuers will be exempt from a number of provisions of the Listing Rules. However, if trading in the shares of a Qualifying Corporate WVR Issuer migrates to the Exchange's markets on a permanent basis, the Exchange would treat the issuer as having a dual-primary listing and the exceptions set out in Rule 19C.11 of the Listing Rules will no longer apply. Such issuer would be required to comply with the Listing Rules provisions which were originally exempted under Rule 19C.11 after a grace period of one year. However, it will be allowed to retain its existing corporate WVR structure.

As the issue regarding WVR regime remains controversial, it is envisaged that the Exchange could only proceed with implementing its proposal after a stronger consensus in the market has been reached.

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