

Exchange Launches Consultation on the extension of Weighted Voting Rights to corporate controllers

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On 31 January 2020, The Stock Exchange of Hong Kong Limited (HKEX) published a consultation paper seeking public feedback on a proposal to allow corporate entities to benefit from weighted voting rights (WVR), subject to additional conditions and investor safeguards (Corporate WVR Consultation).

Background

In April 2018, HKEX introduced a new listing regime for companies from emerging and innovative sectors to list in Hong Kong with weighted voting rights, subject to a number of additional investor protection safeguards given the potential risks associated with a weighted voting rights structure. This includes a limitation on the beneficiaries of weighted voting rights of a company seeking a primary listing on HKEX with weighted voting rights (i.e. under the new Chapter 8A of the Listing Rules) to individuals who are (and remain as) directors of the listed company. At the time HKEX indicated that a number of stakeholders had suggested that corporate shareholders should also be permitted to benefit from weighted voting rights, and that it would consult the market separately on this subject. After some delay, the Corporate WVR Consultation was launched following extensive discussions with stakeholders and between the regulators.

Key Proposals

HKEX is proposing to broaden Chapter 8A of the Listing Rules to permit corporate shareholders to also benefit from weighted voting rights, subject to a number of additional requirements and

safeguards on top of the existing safeguards in Chapter 8A.

Our view

The proposals in the Corporate WVR Consultation builds upon the earlier reforms of the HKEX with the aim of enhancing Hong Kong's competitiveness as a listing venue to "new economy" companies. A majority of mainland based "unicorn companies" have well-established corporate shareholders whose support is important, if not crucial, to the success of these unlisted unicorn companies. These corporate shareholders often seek weighted voting rights as a means of maintain control over companies in their "ecosystem". The proposed enhancements to the existing Hong Kong regime in the Corporate WVR Consultation would be a welcoming development to these unicorn companies and for the Hong Kong capital market.

In the effort to strike a balance between addressing the needs of potential issuers whilst maintaining a sufficient level of shareholder protection, the proposals inevitably limit eligibility for corporate weighted voting rights to a limited number of well-established corporates that control a "business ecosystem" (see details below) of which the listing applicant is a part. While the eligibility requirements suggest that the proposals are primarily aimed at attracting innovative companies that are part of the business ecosystems of tech giants, there are two important details within these requirements worth noting.

- The eligibility requirements acknowledge that a traditional economy company could also develop a complex ecosystem and become eligible for weighted voting rights even if its main business remains part of the traditional economy. This represents a significant potential opportunity for established traditional economy companies, particularly those in the banking and insurance sector which has seen increasing investment in innovation and technology over recent years.
- Whilst the eligibility criteria requires the ecosystem to be made up of a community of companies and other components, this could be made up of non-legal entities such as business units of the corporate shareholder. This suggests that an eligible ecosystem could be made up of just the listing applicant and the corporate shareholder (with different business units focusing on different parts of the ecosystem), so that corporate shareholders whose ecosystem is at an earlier stage of development could also potentially benefit from weighted voting rights.

In addition to the strict eligibility requirements, the proposals also include a number of important limitations on weighted voting rights which some issuers and corporate shareholders may find restrictive. In particular, corporate shareholders may be unwilling to be subject to a time-defined sunset of ten years. Further, the requirement for an individual beneficiary of weighted voting rights to convert part of the weighted voting rights shares upon the sunset of the corporate shareholder may meet resistance from these founder shareholders. It is likely that a number of interest groups will make submissions and lobby for a relaxation to some of these restrictions.

Finally it is worth remembering that the proposals in the Corporate WVR Consultation is for an issuer seeking a primary listing on HKEX. For eligible issuers seeking a secondary listing under Chapter 19C of the Listing Rules, their existing corporate shareholders could continue to benefit from weighted voting rights without being subject to

the proposed eligibility requirements and safeguards.

The key requirements and safeguards in the Corporate WVR Consultation are detailed below.

Eligibility requirements on the corporate shareholder

The corporate shareholder must:

- be a company listed on HKEX, NYSE or the Main Market of the LSE (with a premium listing);
- have an expected market capitalisation of not less than HK\$200 billion (both at the time of listing and based on average market capitalisation over the preceding three months);
- have an economic interest of not less than 10% and have been materially involved in the management or the business of the listing applicant for a period of not less than two financial years before listing, and have an interest of not less than 30% at the time of listing;
- demonstrate that either it is itself an innovative company or that it has a track record of investments in, and contributions to, innovative companies;
- be of relative size to the listing applicant, such that the listing applicant must not represent more than 30% of the corporate shareholder in terms of market capitalisation at the time of listing; and

The corporate shareholder must maintain an economic interest of not less than 30% in the listing applicant post-listing. Relaxation to the existing Listing Rules have been included in the proposals to allow a corporate shareholder to subscribe for shares for the sole purpose of maintaining the 30% interest without the need for shareholders' approval.

Contribution of the corporate shareholder

In order to be eligible for weighted voting rights, a corporate shareholder is required to demonstrate the existence of a business ecosystem exist between it and the listing applicant:

- which is a community of companies (including the listing applicant) and other components (which may be business units and other non-legal entities) that has grown and co-evolved around a technology or know-how platform or a set of core products/services which is owned by the corporate shareholder;
- the components (of the ecosystem both benefit from and contribute to the ecosystem through the sharing of data, users and/or technology;
- which is of meaningful scale, normally measured by reference to indicators such as the number and sophistication of its components, the size of its combined user base, or the frequency and extent of cross-interaction between users/customers of different components;
- core components (of the ecosystem) are in substance controlled by the corporate shareholder; and
- which has materially contributed to the growth and success of the listing applicant by virtue of its participation in the ecosystem.

The weighted voting rights of the corporate shareholder will lapse if the intangible contribution of the corporate shareholder (e.g. access to the ecosystem) is substantially terminated or materially disrupted or suspended for more than 12 months.

Limit on voting rights ratio

The weighted voting rights attached to the shares of a corporate shareholder would be limited to not more than five times the voting power of ordinary shares (individuals are capped at ten times).

Corporate representative

The corporate shareholder is required to maintain a corporate representative (being an officer of the corporate shareholder) on the board of the listing applicant as its representative.

Sunset

The weighted voting rights attached to the shares of the corporate shareholder would be subject to a sunset of not more than ten years, unless renewed through the approval of independent shareholders for further period(s) of five years.

Any individual shareholder with weighted voting rights will be required to convert part of their shares with weighted voting rights into ordinary shares upon the sunset of the corporate shareholder such that the proportion of votes held by the individual shareholder would be the same both before and after the sunset of the corporate shareholder.

Consultation Timetable

The Corporate WVR Consultation is open for public comment until 1 May 2020.

The full Corporate WVR Consultation paper and can be found [here](#).



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