

A BRIEF DISCUSSION ON THE RETURNING TO THE HONG KONG STOCK MARKET OF THE US-LISTED CHINESE COMPANIES

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LC Lawyers
林朱律師事務所
Law firm member of the
EY global network

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I. Introduction

On May 20, the United States Senate unanimously passed the “Holding Foreign Companies Accountable Act”, which not only requires issuers of certain securities to prove that they are not owned or controlled by a foreign government, but also grants US regulators the power to inspect listed companies, otherwise the trading of the securities of these companies in US securities markets would be banned. However, according to the relevant Chinese laws and regulations, cross-border securities supervision should be conducted by the China Securities Regulatory Commission, and on-site inspections should be conducted primarily by Chinese regulators or rely on the inspection results of Chinese regulators. As a result, this new Act would conflict with the relevant Chinese laws and regulations, which could result in a dilemma for US-listed Chinese companies, leading to a large number of delisting cases.

In light of the above, more US-listed Chinese companies may be driven to Hong Kong as an alternative listing venue considering its global market exposure, as well as its status as an international financial market. This article would discuss the issues relating to the return of US-listed Chinese companies to Hong Kong.

II. Advantages of Hong Kong

For US-listed Chinese companies, the process of returning to the Hong Kong capital market is relatively simpler than returning to the A-shares market.

1. The need for group restructuring

Firstly, in terms of the jurisdiction of incorporation of the listing entity, the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**MBLR**”) and the Rules Governing the Listing of Securities on GEM (the “**GEMLR**”) expressly provide that companies incorporated in Hong Kong, Bermuda, the Cayman Islands and Mainland China would be eligible to list on The Stock Exchange of Hong Kong Limited (the “**Exchange**”). In addition, the Exchange will also accept certain other jurisdictions of incorporation, including Australia, the British Virgin Islands, Canada, India, Singapore, Japan, Italy and certain states of the United States. Therefore, for a US-listed red-chip company, if the listing entity was incorporated in a jurisdiction accepted by the Exchange, listing on the Exchange would not require any special adjustments to its shareholding structure (e.g. red-chip structure).

2. Different routes for companies to return to the Hong Kong stock market

Due to the high cost of delisting by privatization and the uncertainty faced by re-listing after delisting, in addition to apply for listing in Hong Kong after delisting in the US, for companies which listing in the US is still allowed, they may also consider dual listing in both the US and Hong Kong. For companies already listed overseas which wish to list on the Exchange at the same time, there are two available options: a primary listing in Hong Kong (i.e. dual primary listing), or a secondary listing in Hong Kong only.

Dual listing offers benefits for both the company and its investors. From the company’s perspective, dual listing broadens its shareholder base and increases its visibility in the global market, which allows the company to seek financing from other securities markets, and further expand its business into other markets.

III. Choice of route for companies returning to Hong Kong stock market

1. Delisting from the US and listing in Hong Kong

If a company chooses this route, it should delist from the US securities market by way of privatization and then apply to list in Hong Kong. The disadvantages of this route are that the costs will be relatively higher, there will be a certain level of uncertainties and it will also be more time-consuming. However, if the US regulators do tighten the laws and regulations rendering certain Chinese companies can no longer maintain their listing status in the stock exchanges in the US, this would become the only choice available for these US-listed Chinese companies.

2. Dual primary listing in the US and Hong Kong

If the company opts for dual primary listing in Hong Kong, the rules that it has to comply with will be the same as the requirements applicable to those companies conducting initial public offering in Hong Kong.

3. Secondary listing in Hong Kong

If the company only conducts secondary listing in Hong Kong, the Exchange will expect the securities of the company to be traded mainly on the overseas stock exchange and to be subject to the supervision of regulators of its primary listing venue. Hence, the Exchange will adopt a relatively less stringent approving standard, with various exemptions and preferential policies. Hence, secondary listing has a stronger operability.

IV. Listing qualifications in Hong Kong

1. General listing qualifications for Main Board and GEM

A. Trading record and financial requirements

Both the Main Board and GEM listing applicants are required to meet certain financial metrics to meet the basic listing application requirements.

For Main Board, there are three financial standards under Rule 8.05 of MBLR: (1) the profit test; (2) market capitalization/revenue/cash flow test; and (3) market capitalization/revenue test. The listing applicants must satisfy one of these financial standards. The listing applicant will also need to have a trading record of not less than three financial years (subject to the exception for biotech companies under Chapter 18A of the MBLR) and management continuity for at least the three preceding years and ownership continuity and control for at least the most recent audited financial year.

Whereas for listing on GEM, the financial requirements under Chapter 11 of the GEMLR focus on market capitalization and positive cash flow. The listing applicant will also need to have a trading record of not less than two financial years, management continuity for at least the two preceding years and ownership continuity and control for at least the most recent audited financial year.

The follow table sets out the major requirements for listing on the Main Board and GEM:

	Main Board			GEM
	Financial requirements (satisfy one of the below tests)			Financial requirements
	Profit test	Market cap / Revenue / Cashflow test	Market cap / revenue test	
Profit	≥ HK\$50m note 1	-	-	-
Market capitalization	-	≥ HK\$2 bn	≥ HK\$4 bn	≥ HK\$150m
Latest year revenue	-	≥ HK\$500m	≥ HK\$500m	-

Positive cash flow	-	≥ HK\$100m for the 3 preceding financial years	-	≥ HK\$30m for the 2 preceding financial years
Trading records	≥ 3 financial years		≥ 2 financial years	
Management continuity <small>note 2</small>	≥ 3 preceding financial years		≥ 2 preceding financial years	
Ownership continuity	at least the most recent audited financial year			

Note:

1. For the most recent year, the profit attributable to shareholder must not be less than HK\$20m and, for the two preceding years, it must not be less than HK\$30m.
2. Listing Decision LD45-1 noted that the Exchange will attribute proportionately greater responsibility to officers with more senior positions than those with more junior positions. It will focus on reviewing the substance of the management, particularly whether there is an identifiable group of individuals remained with management responsibility throughout the relevant track record period and they form the core management of the listing applicant at the time of listing and thereafter.

B. Other requirements

Other listing requirements include qualification requirements of directors, public float and spread of shareholders and suitability for listing.

For red-chip companies which adopt variable interest entities (“VIE”) structures, it is important to note that under Listing Decision HKEX-LD43-3 (“LD43-3”) of the Exchange, all listing applicants are required to meet “narrowly tailored” principle that applicants can only use VIE structures to avoid foreign investment restriction or prohibition. Where possible, listing applicants would be required to demonstrate genuine efforts to comply with applicable laws and regulations. But under the MBLR, for a secondary listing applicant which has listed on an overseas stock exchange with its VIE structure on or before 15 December 2017, the applicant may be exempted from strict compliance of LD43-3 and may list with its existing VIE structure in place.

In addition, there are certain other listing requirements focusing on the securities to be issued. Both the MBLR and GEMLR require the securities to be issued be freely transferable. Also, the voting power of the shares must bear a reasonable relationship to the equity interest those shares represent. However, with the new Chapter 8A of the MBLR, which came into effect in April 2018, listing applicants with weighted voting rights (“WVR”) structure may be allowed to list on the Main Board.

2. Specific listing requirements for applicants with WVR structures

In addition to satisfying the general listing qualifications as aforementioned, listing applicants with WVR structure must demonstrate that it has met certain additional characteristics for the purpose of demonstrating to the Exchange that it is suitable for listing in Hong Kong with a WVR structure, a summary of which is set out below (please refer to Guidance Letter GL93-18 of the Exchange for more details):

A. Innovative

Firstly, the listing applicants should be an innovative company with the following characteristics:

- 1) its success is attributable to the application, to the company's core business, of (i) new technologies; (ii) innovations; and/or (iii) a new business model;
- 2) research and development are a significant contributor of its expected value and constitutes a major activity and expense;
- 3) its success is attributable to its unique features or intellectual property; and/or
- 4) it has an outsized market capitalization/intangible asset value relative to its tangible asset value.

Whether the listing applicant is "innovative" will depend on the state of the industry and market that the listing applicant operates which will be ever-changing as the technology, market and industry develop.

B. WVR holders

For WVR holders, they must have an active executive role within the business and must continue to be a director at the time of listing. They must also have been materially responsible for the growth of the business by way of their skills, knowledge or strategic direction in circumstances where the value of the company is mainly derived from intangible human capital. Nevertheless, their voting power shall not be more than 10 times of the voting power of the non-WVR holders. The listing applicants must also ensure that the non-WVR holder will hold at least 10% of the voting powers of the shares.

C. Financial requirements

There are two financial requirements for the WVR conditions to meet. The first concerns market capitalization, whereby the listing applicant must achieve, at the time of listing, either:

- 1) a market capitalization of at least HK\$40bn; or
- 2) a market capitalization of at least HK\$10bn and revenue of at least HK\$1bn for the most recent audited financial year.

Another financial requirement concerns external validation in which there must be previous third-party investment from at least one "sophisticated investor". The Exchange, in considering whether an investor is "sophisticated", will consider the investor's knowledge and expertise in the relevant field, investment experience and net assets etc. Such investor(s) must retain an aggregate 50% of its/their investment for a period no less than six months after listing.

V. Secondary listing under the concessionary route

1. Secondary listing requirements

A. Type of applicant

Chapter 19C of MBLR became effective in April 2018, which provides a secondary listing channel for companies with certain characteristics and for the first times allows companies with their center of gravity in the Greater China (“**Greater China Issuer**”) to conduct secondary listing in Hong Kong. Generally speaking, a “Qualifying Issuer” (being an issuer primary listed on a “Qualifying Exchange”, and “Qualifying Exchange” includes the New York Stock Exchange LLC, the Nasdaq Stock Market or the Main Market of the London Stock Exchange plc (and belonging to the UK Financial Conduct Authority’s “Premium Listing” segment)) and also being an “innovative company”, is normally considered as a suitable candidate for the purpose of secondary listing under Chapter 19C. According to the Guidance Letter GL94-18 issued by the Exchange, the Exchange normally assesses whether a company is an “innovative company” by considering whether it possess more than one of the following characteristics:

- 1) its success is demonstrated to be attributable to the application, to the company’s core business, of (i) new technologies; (ii) innovations; and/or (iii) a new business model, which also serves to differentiate the company from existing players;
- 2) research and development is a significant contributor of its expected value and constitutes a major activity and expense;
- 3) its success is demonstrated to be attributable to its unique features or intellectual property; and/or
- 4) it has an outsized market capitalization / intangible asset value relative to its tangible asset value.

B. Qualifications for secondary listing

A Qualifying Issuer must have a good track record of compliance for at least two full financial years on a Qualifying Exchange.

A Qualifying Issuer with a WVR structure must have a market capitalization of at least HK\$40bn at the time of secondary listing, or a market capitalization of at least HK\$10bn at the time of secondary listing with a revenue of at least HK\$1bn for the most recent audited financial year.

2. Concessionary treatment for listing applicants of secondary listing

Issuers applying for secondary listing in Hong Kong are entitled to a number of automatic or conditional waivers from compliance with certain requirements of the MBLR, including issuer’s internal organization, corporate governance standards, listing channels, dealings in securities and

restrictions on transfer, connected transactions, disclosure in annual report, requirements relating to the appointment of auditor and compliance adviser, share option schemes, environmental and social matters as well as compliance by directors with Model Code for Securities Transaction by Director of Listed Issuers and Code on Share Buy-backs.

The following table sets out the different concessionary treatments applicable to different types of Greater China Issuers under Chapter 19C of the MBLR:

	“Non-Grandfathered Greater China Issuer”	“Grandfathered Greater China Issuer”
Definition	“Non-Grandfathered Greater China Issuer” means companies with center of gravity in Greater China and listed on a Qualifying Exchange after 15 December 2017.	“Grandfathered Greater China Issuer” means companies with center of gravity in Greater China and listed on a Qualifying Exchange on or before 15 December 2017.
Requirements on equivalent standards of shareholder protection	The applicant is required by the MBLR to amend its constitutional documents to ensure the standard of shareholder protection are comparable to those provided in Hong Kong.	The applicant is not required by the MBLR to amend its constitutional documents. However, it must demonstrate how the domestic laws, rules and regulations to which it is subject and its constitutional documents, in combination, provide the shareholder protection standards set out in Chapter 19C. The Exchange may require the company to amend its constitutional documents to provide such shareholder protection standards.
VIE structures (if applicable)	The applicant is required to comply with all existing requirements regarding VIE structures.	The applicant may list with its existing VIE structure and will not be required to demonstrate that it is able to comply with the draft PRC Foreign Investment Law. However, it must provide the Exchange with a PRC legal opinion confirming that the VIE structure comply with PRC laws, rules and regulations, and complies with the disclosure requirements under LD43-3.
WVR structures (if applicable)	The applicant is required to meet the eligibility and suitability criteria for primary listing with a WVR structure. It must conform to all primary listing requirements including ongoing WVR safeguards.	The applicant may list with its existing WVR, and is not required to comply with ongoing WVR safeguards, except for disclosure requirements.
Automatic waivers from full compliance with the MBLR	The applicant will enjoy automatic waivers from full compliance with the MBLR, but if, after its secondary listing in Hong Kong, 55% or more of the total worldwide trading volume, by dollar value, of its shares migrates to Hong Kong in the most recent fiscal year, the applicant would be treated as having a dual primary listing in Hong Kong and the automatic waivers will no longer apply.	

	"Non-Grandfathered Greater China Issuer"	"Grandfathered Greater China Issuer"
	The applicant will have a grace period of 12 months to comply with the applicable requirements. Such grace period will commence from the Exchange's written notice of its decision that majority of trading in the company's listed shares has migrated permanently to Hong Kong.	

3. Other requirements for secondary listing on the Exchange

In addition to complying with the general requirements for Hong Kong applicants, red-chip companies seeking secondary listing in Hong Kong are also required to comply with the additional requirements under Chapter 19 of the MBLR. The major requirements include:

- 1) the Exchange reserves the right to refuse a secondary listing in its absolute discretion if: (i) the Exchange believes it is not in the public interests to list such an applicant; or (ii) the Exchange is not satisfied that the overseas applicant's primary listing is or is to be on an exchange where the standards of shareholder protection are at least equivalent to those provided in Hong Kong;
- 2) throughout the period during which the overseas applicant's securities are listed on the Exchange, the overseas applicant must appoint and maintain a person to accept service of process and notices on its behalf in Hong Kong;
- 3) only securities registered on the Hong Kong register can be traded on the Exchange; and
- 4) the approval for listing of the applicant on its primary exchange must have been granted before the approval for listing on the Exchange can be granted.

KEY CONTACTS



Bonnie Yung
Partner
Bonnie.Yung@eylaw.com.hk
+852 3471 2668



Jason Wang
Partner
Jason.Wang@eylaw.com.hk
+852 2675 2172

Contact us

LC Lawyers LLP
Suite 3106,
31/F One Taikoo Place,
979 King's Road,
Quarry Bay, Hong Kong
Tel: (852) 2629 3200
Fax: (852) 2956 1980
https://www.eylaw.com.hk/en_hk

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