Skadden

Hong Kong Stock Exchange Poised To List New Economy Companies Trading Abroad

Partners

Christopher W. Betts / Hong Kong

Paloma Wang / Hong Kong

Associate

Allan Wan / Hong Kong

Leading Chinese e-commerce company Alibaba, which has a primary listing on the New York Stock Exchange, made its long-awaited Hong Kong Stock Exchange (HKEx) debut in November 2019. This marked the first secondary listing in Hong Kong under a new regime for China-based issuers.

The HKEx revamped its rules in April 2018 to facilitate the secondary listing of China-based companies that operate in innovative, new economy sectors. (Biotech companies are excluded since they were the subject of separate listing reforms; see our June 18, 2019, client alert "HKEx Reforms Attract High-Profile Technology and Biotech Listings.") The new rules enable these companies to dispense with the myriad prospectus disclosure requirements, mandatory shareholder protection standards in corporate constitutional documents and post-listing compliance obligations that are applicable to companies conducting a primary listing in Hong Kong. Importantly, the HKEx retains the discretion to determine whether a company is "suitable" for listing under the new rules (including whether it is sufficiently "innovative"). Companies must have either (i) a market capitalization in excess of HK$4 billion (US$513 million) or (ii) a market capitalization in excess of HK$10 billion (US$1.28 billion) with revenues in excess of HK$1 billion (US$128 million) in the most recent financial year — ensuring that the number of companies potentially benefitting from the rules remains relatively constrained.

The new rules divide Chinese companies that are listed abroad into two categories depending on whether they were listed before (grandfathered) or after (non-grandfathered) December 15, 2017, with grandfathered issuers having significantly fewer listing requirements. In addition to the various waivers applicable to grandfathered companies, Alibaba received additional waivers from the HKEx for a variety of listing and post-listing obligations not provided for under the rules. A recurring argument Alibaba made in support of the waivers was that it already was subject to commensurate, albeit different, disclosure obligations and regulatory oversight under U.S. securities laws. The result paved the way for Alibaba's listing, simplified its disclosure requirements and reduced its ongoing compliance burden.

To complement the new issuer-friendly secondary listing rules, the HKEx and two mainland bourses, the Shanghai Stock Exchange and the Shenzhen Stock Exchange, recently agreed to allow secondary issuers in Hong Kong to participate in the Shanghai and Shenzhen Stock Connect programs. These programs enable mainland China-based investors to trade directly in certain HKEx-listed securities (southbound trading) and Hong Kong-based investors to trade directly in certain Shanghai and Shenzhen Stock Exchange-listed securities (northbound trading). The Stock Connect programs previously excluded the securities of Hong Kong-listed companies with weighted voting rights (WVRs). That exclusion was officially lifted in October 2019 when the Shanghai and Shenzhen Stock Exchanges promulgated new rules to allow companies structured with WVRs to participate in the Stock Connect programs, provided they are constituent securities of the Hang Seng Composite Index (an index that covers almost 500 stocks representing approximately 95% of total market capitalization) and meet certain thresholds for market capitalization, liquidity and trading period. In the same month, Xiaomi Corporation, a leading Chinese technology company, and Meituan-Dianping, a leading Chinese e-commerce platform for services, were among the first companies with WVR structures to be admitted to the Stock Connect programs.

For major U.S.-listed Chinese companies, the ability to access mainland Chinese markets via the Stock Connect programs without the regulatory burden of a Hong Kong primary listing is a potentially attractive proposition. According to the HKEx's data, the total value of southbound trading in 2019 amounted to HK$2.3 trillion (US$300.1 billion), with an average of 202,990 daily trades. Mainland China-based investors held HK$999.5 billion (US$127.8 billion) worth of Hong Kong-listed shares through the Stock Connect programs as of the end of October 2019, up from HK$13.1 billion (US$1.7 billion) at the end of 2014.

Alibaba, Xiaomi Corporation and Meituan-Dianping, despite being members of the 400-constituent Hang Seng Composite Index, are not qualified to be admitted into the 50-member benchmark Hang Seng Index (HSI) or Hang Seng China Enterprises Index under the current admission rules, because only companies with a primary listing and without a WVR structure are eligible. Companies often covet membership in the benchmark HSI because it is the most widely quoted gauge of the Hong Kong stock market, potentially resulting in significant inflows for companies from the funds that track it. HSI inclusion for secondary-listed issuers and issuers with a WVR structure is therefore likely to be the next major step for Hong Kong to take to enhance its capital markets platform.

Hang Seng Indexes Company Limited, the entity responsible for managing the family of Hang Seng indexes, recently announced its plan to conduct a market consultation for expanding the constituent eligibility of the HSI in the first quarter of 2020, with the results expected to be published in May 2020. Market participants and U.S.-listed Chinese technology companies contemplating a Hong Kong secondary listing will be interested to see if an HSI inclusion will be introduced.

Conclusion

Against the backdrop of a prolonged series of large-scale anti-government protests, the successful completion of the Alibaba deal under the new secondary listing regime could spark a new wave of secondary listings in Hong Kong of Chinese new economy companies. For well-known technology giants, the potential to penetrate the mainland Chinese markets via the Shanghai and Shenzhen Stock Connect programs will be a powerful incentive to pursue a secondary listing in Hong Kong. A move to amend the rules of admission into the HSI to render issuers with a secondary listing or a WVR structure eligible for index inclusion will further boost that attraction.