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Hong Kong's Exchange Improves Its Allure for Chinese Issuers

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Despite the impact of COVID-19 and other recent developments in Hong Kong, the city's role as a center for China-based companies to raise capital became even more important in 2020. The momentum of several trends that began developing a year ago has, if anything, played out in a far more pronounced manner than we anticipated.

Two significant trends emerged in late 2019:

- new secondary listings on the Hong Kong Stock Exchange (HKEX) of large, primarily tech-related companies that were already listed in the United States; and
- the expansion of HKEX's position as a credible market for biotech and health care companies to raise capital.

Both trends stem from new HKEX rules adopted in 2018, but these changes really did not begin to have an impact until 2020.

At the beginning of 2020, Alibaba was the only U.S.-listed company that had completed a secondary listing under the new rules. By the end of 2020, there were 10 so-called "homecoming IPOs" on HKEX, with concurrent public offerings in Hong Kong. Among these were the listings of JD.com and NetEase, two of the three largest public offerings in Hong Kong in the first half of 2020. For the full year, approximately $17 billion was raised through such offerings.

This trend has been driven in part by regulatory developments in the U.S. In December 2020, the Holding Foreign Companies Accountable Act was signed into law by President Trump, prohibiting foreign companies from listing on U.S. exchanges if they retain a foreign accounting firm that cannot be inspected by the Public Company Accounting Oversight Board (PCAOB) for three consecutive years, beginning in 2021. Because inspection of audit firms' working papers in China is subject to regulations in China, there is hope that the Securities and Exchange Commission and PCAOB will reach an understanding within the next three years with the relevant Chinese authorities on PCAOB inspection of the audit working papers in China. However, the new law comes against the backdrop of a challenging period in the U.S.-China relationship, and Chinese regulators' concerns about national security threats are ongoing, creating headwinds for any efforts to reach an understanding. (See "US-China Trade and Enforcement Issues: What's Next?") A critical mass of U.S.-listed Chinese tech companies chose to avail themselves of a secondary listing in Hong Kong this year as a contingency plan and to create an additional platform for raising capital closer to many of their stakeholders, making it more likely that additional companies will follow.

The second trend, even more pronounced, is the increase in pre-revenue biotech companies listing on HKEX. The 28 biotech companies now listed on HKEX had a collective market capitalization of almost $90 billion at the end of 2020, and an ecosystem of other stakeholders is growing around them, including investors, research analysts and senior executives. Unlike some prior HKEX initiatives that were met with a more muted response (such as the effort to attract mining companies to HKEX), the exchange's biotech initiative has now gained sufficient critical mass. Given the rapid growth in health care-related spending in China and the significant room for further growth, the positive reception to HKEX's biotech initiative is clearly underpinned by a more solid macroeconomic story.

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Adding to the momentum in this sector, many of HKEX's biotech companies have seen significant share price appreciation and have been able to conduct sizeable follow-on offerings. Several have now also gone on to complete domestic Chinese offerings of A shares. (Chinese regulations prohibit domestically traded A shares from being exchangeable for Hong Kong or other foreign-listed securities.)

To make HKEX even more attractive to biotech companies, in November 2020, HKEX announced an agreement with the Shanghai and Shenzhen stock exchanges (SSE and SZSE, respectively) that shares of pre-revenue biotech companies are eligible to be traded through the Stock Connect program. The program allows investors located in Shanghai and Shenzhen to trade directly in certain HKEX-listed securities (southbound trading) while also permitting Hong Kong-based investors to trade directly in certain SSE- and SZSE-listed securities (northbound trading). Specifically, pre-revenue biotech companies listed under Chapter 18A of the Hong Kong Listing Rules that are eligible constituent stocks of the Hang Seng Composite Index, or have corresponding A shares listed on SSE or SZSE, will be included in southbound trading under the existing Stock Connect arrangements. These changes are expected to take effect in early 2021.

In the meantime, HKEX has been soliciting feedback on various amendments to its listing rules, some of which are arguably long overdue. The proposals include amendments aimed at:

- facilitating a "paperless" initial public offering (IPO) process, doing away with the need to print tens of thousands of physical prospectuses and application forms and making them available at retail bank branches throughout Hong Kong;
- shortening the IPO settlement process, most significantly by reducing the exceedingly long period between pricing and closing for Hong Kong IPOs from five business days to one;
- strengthening the disciplinary powers of HKEX, for example by providing HKEX with the ability to delist companies that retain directors or officers who have overseen flagrant breaches of HKEX listing rules; and
- continuing to raise the standards for initial listings (including by raising the minimum profit requirements for listings on the Main Board of HKEX) and closing perceived loopholes that HKEX fears may lead to listings of companies that are or may become "listed shells."

For the last decade, HKEX has been the No. 1 market globally for IPOs by funds raised. It has benefited from its market position as the only licensed exchange in Hong Kong and the only market within China where Chinese companies can raise capital freely exchangeable into foreign currency. HKEX also has as an advantage its proximity to mainland China and the perception that it is the "home" market of choice for Chinese issuers. Against a shifting geopolitical backdrop that may continue to favor it as a listing venue, HKEX is seeking to strengthen its position with China-based issuers. However, whether HKEX can become an attractive venue for issuers beyond those with immediate and deep links to China remains to be seen.