

THE INITIAL PUBLIC
OFFERINGS
LAW REVIEW

SECOND EDITION

Editor
David J Goldschmidt

THE LAWREVIEWS

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PREFACE

Welcome to the second edition of *The Initial Public Offerings Law Review*. This publication introduces the reader to the main stock exchanges around the globe and their related IPO regulatory environments, and provides insight into the legal and procedural IPO landscapes in 21 different jurisdictions. Each chapter gives a general overview of the IPO process in the region, addresses regulatory and exchange requirements, and presents key offering considerations.

The global IPO landscape is ever-changing. While several of the oldest stock exchanges, such as the New York Stock Exchange and London Stock Exchange, are still at the forefront of the global IPO market, the world's major stock exchanges now are scattered around the globe and many are now publicly traded companies themselves. IPOs take place in nearly every corner of the world and involve a wide variety of companies in terms of size, industry and geography. Aside from general globalisation, shifting investor sentiment and economic, political and regulatory factors have also influenced the development and evolution of the global IPO market.

Virtually all markets around the globe have experienced significant volatility in recent years; however, 2017 marked a resurgence for many IPO markets. The number of 2017 IPOs and total proceeds raised were led by the Asia-Pacific exchanges, with many other regions also experiencing improvement over recent years. Despite the increase in available private capital, which has enabled issuers to remain private for longer periods of time, there is continued optimism for 2018 in terms of both global deal count and proceeds. The strong global IPO pipeline includes many well-known companies across a range of industries, and it is anticipated that these companies will seek to list on a variety of stock exchanges around the world.

Every exchange operates with its own set of rules and requirements for conducting an IPO. Country-specific regulatory landscapes are often dramatically different between jurisdictions as well. Whether a company is looking to list in its home country or is exploring listing outside of its own jurisdiction, it is important that the company and its management are aware from the outset of the legal requirements as well as potential pitfalls that may impact the offering. Moreover, once a company is public, there are ongoing jurisdiction-specific disclosure and other requirements with which it must comply. This second edition of *The Initial Public Offerings Law Review* introduces the intricacies of taking a company public in these jurisdictions and serves as a guide for issuers and their directors and management.

David J Goldschmidt

Skadden, Arps, Slate, Meagher & Flom LLP

New York

March 2018

HONG KONG

Christopher Betts, Antony Dapiran and Anthony Pang¹

I INTRODUCTION

While 2017 saw Hong Kong's initial public offering (IPO) market lose its top ranking to New York in terms of total funds raised, it will primarily be remembered as the year in which privately owned enterprises overtook Chinese state-owned enterprises as the key driver of the market, with seven of the top 10 IPOs being made by private enterprises, of which four were technology-related or 'new economy' companies. Even more significantly, in December 2017, the Stock Exchange of Hong Kong Limited (HKEx) announced that it proposed to revise the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the Listing Rules) to facilitate the listings of (1) companies with dual-class share structures (or what the HKEx refers to as 'weighted voting rights (WVRs)'), (2) pre-revenue biotech companies and (3) companies with a 'centre of gravity' in China and an existing listing on certain foreign stock exchanges. These amendments to the Listing Rules, which were subsequently outlined in a consultation paper issued by the HKEx in February 2018, represent the most significant change to the Hong Kong IPO regulatory landscape since the first 'H share' IPO in 1993 (which created the framework for listing companies incorporated in China), and are expected to lead to a wave of new technology and biotech companies listing in Hong Kong.

The Securities and Futures Commission of Hong Kong (SFC) is the primary regulator for the Hong Kong securities market and is also responsible for the licensing and supervision of stock exchanges – which is currently limited to the two boards operated by the HKEx: the Main Board and the Growth Enterprises Market (GEM) board. IPOs are currently reviewed by both the SFC and the HKEx, the latter of which is broken down into the Listing Division, responsible for vetting listing applications, and the Listing Committee, which is responsible for approving (or rejecting) listing applications submitted to it by the Listing Division at the end of the vetting process.

Hong Kong adopts a substantive merits-based IPO review process with the aim of protecting retail investors by preventing problematic or risky companies from listing on the HKEx. This approach differs from other markets that have disclosure-based regimes (most notably the United States), and is driven in large part by the fact that Hong Kong law does not currently permit shareholders' class action law suits, litigation funding or contingency-based legal fees for contentious legal matters (thus significantly reducing any risk of post-IPO shareholder litigation), and also by the fact that controlling shareholders and directors of

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Hong Kong listed companies are typically not situated in Hong Kong (thus reducing the chances of any successful litigation or enforcement actions being brought against them). The high degree of retail participation in the Hong Kong market also leads regulators to take a highly protective approach to regulation.

Both the SFC and the HKEx have the power to object to a listing application – in the case of the SFC, that power is contained in subsidiary legislation to the Securities and Futures Ordinance (SFO), which states that the SFC may object to a listing if it does not believe that it is in the interest of the investing public or the public interest, and in the case of the HKEx in Rule 8.04 of the Listing Rules, which states that a listing applicant must, ‘in the opinion of the [HKEx], be suitable for listing’. While there is some official guidance as to circumstances in which the HKEx may question ‘suitability’, the term is deliberately not defined and leaves the HKEx with significant discretion.

II GOVERNING RULES

IPOs in Hong Kong are governed by a mix of both law and rules. The relevant laws are primarily the SFO and Companies (Winding Up and Miscellaneous Provisions) Ordinance (CO), while the primary rules are the Listing Rules and their GEM board counterpart. The SFO governs offerings of securities in Hong Kong generally, while the CO contains provisions with regard to prospectuses issued in connection with securities offerings. The Listing Rules, which are regularly supplemented by the HKEx by way of Guidance Letters and Listing Decisions, set out detailed provisions regarding the application process for listing securities on the HKEx. The Listing Rules are not law but rather operate as the terms of a contract between the HKEx and each listed issuer.

i Main stock exchanges

The HKEx, which is wholly owned by Hong Kong Exchanges and Clearing Limited (itself a public company whose shares are listed on the HKEx) is the sole stock exchange operator in Hong Kong and operates both the Main Board and the GEM board. The Main Board is the principal and most important exchange in Hong Kong. While for many years Chinese state-owned enterprises have represented the majority of funds raised and the largest deals, the balance has now shifted towards privately owned enterprises. The December 2016 US\$630 million IPO of Meitu, Inc initiated a wave of new economy listings in 2017, with the US\$1.53 billion IPO of ZhongAn Online P&C Insurance Co Ltd, the US\$1.06 billion IPO of China Literature Limited and the US\$870 million IPO of Yixin Group Limited representing the three largest tech IPOs of 2017 and three of the four largest IPOs overall.

The GEM board was introduced in 1999 with a view to it being positioned as a Hong Kong equivalent to the Nasdaq, but following an extended period of muted activity its position became largely one of providing a means of listing smaller companies in often quite traditional industries whose shareholders may subsequently look to sell their companies’ listed status. The shift away from its initial goals culminated in the HKEx announcing in December 2017 that it would revamp the GEM board rules to raise the qualifications for listing, remove an existing process whereby companies could transition from the GEM board to the Main Board, and impose extended post-IPO lock-up requirements on controlling shareholders. The new rules took effect in February 2018. Nevertheless, for smaller companies with limited operating histories or that are yet to generate a profit, the GEM remains a viable option.

To reduce its reliance on China-based issuers, the HKEx has actively sought to attract businesses without a dominant Hong Kong or China nexus to list in Hong Kong. Past initiatives by the HKEx have included a set of policies facilitating the listing of companies incorporated by foreign jurisdictions outside of Hong Kong and certain other recognised jurisdictions, providing for extensive relaxations of Listing Rules requirements for international companies seeking a secondary listing in Hong Kong, introducing a chapter of the Listing Rules focused on mining companies, and introducing a ‘Hong Kong depository receipt’ regime. Some of the listings to take advantage of these initiatives have included companies such as Fast Retailing, Prada, Glencore, Prudential and Coach (though Fast Retailing was back in early 2014). For foreign companies, the most significant potential benefit of an IPO or listing on the HKEx would be access to China-based capital, as Chinese government-controlled pension funds are not restricted from investing in Hong Kong securities (unlike securities in other markets), and China-based retail investors can also trade in HKEx listed securities through the Shanghai–Hong Kong Stock Connect and Shenzhen–Hong Kong Stock Connect programmes. The HKEx recently announced amendments to the rules regarding listings of companies with an existing listed status on a foreign exchange that will permit companies that are listed on certain reputable exchanges (including the NYSE and the LSE) to obtain a secondary listing in Hong Kong, even if they have a ‘centre of gravity’ in China – a move clearly designed to attract the likes of Alibaba, Baidu and JD.com to list in Hong Kong.

ii Overview of listing requirements

Objective requirements

Companies seeking to list on the HKEx must either be incorporated in one of a prescribed list of jurisdictions (namely, Hong Kong, China, Bermuda or the Cayman Islands (the recognised jurisdictions)), or a published list of other jurisdictions that the HKEx and SFC have, through a test case, accepted as having shareholder protections comparable to those under Hong Kong law and the Listing Rules (the acceptable jurisdictions). Companies incorporated outside the recognised and acceptable jurisdictions can still list on the HKEx, but must first make a submission to the HKEx and SFC comparing the shareholder protections under the laws of the jurisdiction in which it is incorporated with those of Hong Kong, and describing measures the company proposes to adopt to address any discrepancies (such as amendments to its constitutional documents).

A company applying to list on the Main Board must have a trading record of at least three full financial years and meet any one of the three following financial tests:

- a* ‘profits test’: at least HK\$50 million in profits attributable to shareholders in the last three financial years (with profits of at least HK\$20 million recorded in the most recent year, and aggregate profits of at least HK\$30 million recorded in the two years prior);
- b* ‘market cap/revenue test’: a market cap of at least HK\$4 billion at the time of listing and at least HK\$500 million in revenue during the most recent audited financial year; and
- c* ‘market cap/revenue/cash flow test’: a market cap of at least HK\$2 billion at the time of listing, revenue of at least HK\$500 million for the most recent audited financial year and positive cash flow from operating activities of at least HK\$100 million in aggregate for the three preceding financial years.

In addition, a listing applicant must have management continuity for at least three preceding financial years, which generally requires that there has been no change in the majority of its board of directors or senior management team during the three financial years track-record

period. Also, there has to be a continuous ownership and control of the voting rights attaching to the shares for the latest financial year of the trading record period by the controlling shareholder or, where there is no controlling shareholder, a single largest shareholder. Under test (b) the HKEx may accept a trading record period of less than three years provided the company has been under substantially the same management for one full financial year and the management meets certain industry experience requirements.

Relaxations of the objective criteria may also be available to infrastructure, mining and other companies – though few such companies have listed in the past decade. As noted above, the HKEx is also in the process of adopting new rules to permit pre-revenue biotech companies to list. These rules are expected to require that such companies have been in operation for not less than two years, have at least one product, process or technology that has proceeded beyond the concept stage (for example, having passed Phase I stage in relation to the clinical trial of a drug regulated by relevant drug and safety authorities such as the FDA (US), CFDA (China) or EMA (Europe) and has received all the necessary regulatory approvals to proceed to Phase II, and have a market capitalisation at the time of listing of not less than HK\$1.5 billion.

At the time of the listing and thereafter, a company must have at least 25 per cent of its total issued share capital held by the public. However, the HKEx may accept a lower public float percentage (between 15 per cent and 25 per cent) if a company has an expected market capitalisation at the time of the listing of over HK\$10 billion. The following persons will not be regarded as members of the ‘public’:

- a* ‘connected persons’ of the company (see Section IV.v for a definition of ‘connected persons’);
- b* any person whose acquisition of securities has been financed directly or indirectly by a connected person; and
- c* any person who is accustomed to taking instructions from a connected person with regard to the acquisition, disposal, voting or other disposition of the securities held by such person.

At the time of the listing, a company must have at least 300 shareholders, and at the time of listing no more than 50 per cent of a company’s shares held in public hands can be beneficially owned by the three largest public shareholders. At the time of the listing, the expected market capitalisation of a company’s securities held by the public must be at least HK\$50 million and the total expected market capitalisation must be at least HK\$200 million.

Companies listing on the GEM board are subject to lesser objective listing standards, such as only a two-year trading record requirement, and must (from February 2018) have achieved a positive cash flow of HK\$30 million during the two years prior to listing (without having necessarily achieved a profit).

Further, there are a number of corporate governance-related requirements that must be met in order to list, such as the need for a company’s board of directors to be comprised of not less than one-third independent non-executive directors, subject to a minimum of three, and to establish audit, remuneration and nomination committees.

Subjective requirements

As noted above, the HKEx and SFC will conduct a substantive review of listing applicants to determine whether they are suitable for listing. The suitability rules have, through

the years, been interpreted broadly to render companies with a variety of issues as being unsuitable for listing. These issues, most of which are captured in HKEx Guidance Letter: HKEx-GL68-13, include:

- a* concerns over the integrity and suitability of directors and shareholders;
- b* historical breaches of laws or regulations;
- c* deteriorating financial performance;
- d* over-reliance on a controlling shareholder;
- e* customer or supplier concentration;
- f* a lack of key licences and permits; and
- g* business models considered to be unsustainable by the HKEx.

The HKEx also has specific rules relating to the use of variable interest entity (VIE) structures, which are contractual arrangements used to control entities where direct legal ownership is not possible. VIE structures are often used to control domestic Chinese businesses operating in industries that are subject to foreign ownership restrictions, such as technology-related sectors. HKEx policy requires that the businesses held through VIE structures must be narrowly tailored to situations where there is a clear regulatory barrier to direct legal ownership, and the contracts underlying the VIE structure must also conform to HKEx requirements. The HKEx has used non-compliance with its policy on the use of VIE structures as the basis for determining that a company is unsuitable for listing on a number of occasions.

Due to the high level of discretion exercised by the HKEx in considering whether a company is suitable for listing, it is relatively common for companies with any concerns regarding their suitability to approach the Listing Division of the HKEx in advance of submitting a formal listing application in order to seek their preliminary views with regard to any issues of concern.

Finally, it should be noted that the HKEx has strict guidelines regulating pre-IPO investments that, in a worst case scenario, can require investment agreements to be amended and restated and lead to a 120-day delay to an IPO timetable if not complied with. It is therefore prudent for companies seeking pre-IPO investments to consult with a Hong Kong lawyer prior to an investment being made to ensure that any investment is structured appropriately. Note that the principle of 'fair and equal treatment' of shareholders under the Listing Rules will require that most special shareholder rights granted to pre-IPO investors will be required to fall away upon IPO.

Proposals regarding companies with WVRs

In February 2018, the HKEx released a draft of the proposed rules relating to the listing of companies with weighted voting rights (WVRs). There are a number of requirements that companies with WVRs will be expected to be able to meet. Among others:

- a* applications will be restricted to 'innovative' companies by reference to characteristics set out in a guidance letter to be issued. Currently, the HKEx has indicated that an innovative company would normally be expected to possess one or more of a number of characteristics, including its success being demonstrably attributable to the application of new technology; innovation; business model to the company's core business, which also serves to differentiate the company from existing players; and research and development, a significant contributor to expected value, constituting major activity and expense;

- b* companies should have an expected market capitalisation upon listing of not less than HK\$10 billion, and if the market capitalisation is less than HK\$40 billion, they will also need to have at least HK\$1 billion in revenues in the most recent financial year;
- c* all WVR holders must have been materially responsible for the growth of the business, by way of their skills, knowledge or strategic direction where the value of the company is largely attributable or attached to intangible human capital;
- d* all WVR holders must have an active executive role within the business, and contribute to a material extent to the ongoing growth of the business;
- e* all WVR holders are or would assume the role of director of the issuer at the time of listing;
- f* the company must have received meaningful (being more than just a token investment) third-party funding from sophisticated investors (including financial institutions). Such investors will be required to retain an aggregate 50 per cent of their investment at the time of listing for a period of at least six months post IPO (subject to exceptions for *de minimis* investments by specific investors);
- g* after listing, issuers with WVR structures will be prohibited from increasing the proportion of weighted voting rights in issue or issue any further WVR shares (other than in the case of *pro rata* offerings to all shareholders);
- h* WVRs must be capped at no more than 10 times the voting power of ordinary shares;
- i* certain key matters must be decided on a one-share one-vote basis, including material changes to the issuer's constitutional documents, variation of rights attached to any class of shares, the appointment and removal of independent non-executive directors, the appointment and removal of auditors, and the winding-up of the company;
- j* the HKEx will require a mandatory corporate governance committee comprised of independent directors to ensure that the company is operated and managed for the benefit of all shareholders; the company complies with Hong Kong rules; and the issuer engages a compliance adviser on a permanent basis. Directors and senior management will also be required to undergo appropriate training on WVR and its associated risks; and
- k* the HKEx will place restrictions on a WVR holder's ability to transfer the weighted voting rights attached to their shares and impose a requirement that a beneficiary's WVRs fall away if he or she ceases to be a director, dies or becomes incapacitated.

The consultation period for the draft rules ends on 23 March 2018, with their adoption expected to take place within a month or two of such date. It is anticipated that the consultation process will lead to some changes to the rules from their draft form.

Procedural requirements

The Listing Rules, as supplemented by HKEx Guidance Letters, set out a number of procedural requirements that must be followed when preparing for an IPO in Hong Kong.

Companies seeking to list securities on the HKEx must appoint one or more sponsor banks for their listing not less than two months prior to the date on which they propose to submit their listing application. Sponsors must be licensed with the SFC to provide corporate finance advice, and are typically investment banks that also act as underwriters on the IPO. Multiple sponsors can be appointed, but at least one must be independent from the company by reference to a number of criteria set out in Rule 3A.07 of the Listing Rules.

The principal role of the sponsor is to guide the company through the IPO process, act as the main communication channel between the company and the regulators, and provide various confirmations to the HKEx throughout the IPO process (including that, based on their diligence performed, they are satisfied that the company is suitable for listing). For the reasons described above, and as Hong Kong's regulators have limited enforcement tools when dealing with bad corporate actors (in particular where a listing application is ultimately unsuccessful), the regulators place a very high degree of importance on the role of the sponsor, and sponsors are required (under the Listing Rules and a code of conduct issued by the SFC) to undertake a rigorous diligence exercise in respect of companies wishing to list in Hong Kong. This diligence includes visits to key business sites and interviews with key customers, suppliers and providers of finance. Companies with experience in other markets regularly find the diligence requirements of a Hong Kong IPO significantly more onerous than what they are accustomed to.

The formal phase of the listing application process begins with the filing by the sponsor or sponsors of a prescribed listing application form (the Form A1) with the Listing Division of the HKEx, accompanied by a non-refundable deposit of the initial listing fee, together with an advanced draft of the Hong Kong prospectus and other prescribed documents. A version of the draft prospectus submitted at the time of the listing application must be made available to the public via the website of the HKEx. This contrasts with other markets (most notably the United States, which has steered away from public filings pursuant to the JOBS Act). Exemptions from the public disclosure requirement are available to companies with an existing listing on an exchange outside of Hong Kong. The A1 Filing must be made not less than 25 clear business days prior to the proposed date of the Listing Hearing although, as a practical matter, the vetting process regularly results in the time between the A1 Filing and the Listing Hearing being longer than this.

Once the Listing Division has completed its review of a listing applicant, it will submit the application to the Listing Committee (an independent committee comprised of a broad range of market participants, including bankers, lawyers, accountants, investor representatives and other stakeholders) for the final determination as to whether or not the company should be permitted to list. In principle, once the approval to list is given by the Listing Committee, a company may proceed with its offering process. In practice, very few listing applications are formally rejected, with problematic applications invariably being withdrawn or lapsing before any formal decision is made by either of the regulators.

iii Overview of law and regulations

As noted above, the principal laws governing Hong Kong IPOs are the SFO and the CO. The SFO provides that offerings of securities in Hong Kong can only be made if authorised by the SFC, and prohibits investments to be advertised in Hong Kong other than by way of a prospectus. The CO sets out the principal content requirements for prospectuses issued in connection with Hong Kong IPOs (which are supplemented by further content requirements in the Listing Rules). These content requirements include (but are not limited to):

- a* information about the securities to be listed and the company's share capital;
- b* an overview of the industry (including a regulatory overview);
- c* general information about the company's business and assets;
- d* financial information about the company, including an accountant's report, usually prepared in accordance with International Financial Reporting Standards (although certain other reporting standards are acceptable);

- e* management discussion and analysis of financial condition;
- f* a description of the relationship between the company and its controlling shareholder (including any connected transactions);
- g* a property valuation (if the company is engaged in a property business or the book value of any of its properties represents more than 15 per cent of its total assets);
- h* information about the company's management, directors, securities held by the directors and directors' service contracts;
- i* details of shareholders holding 5 per cent or more of the share capital;
- j* a description of how the IPO proceeds are to be used; and
- k* various material contracts and other documents must be made available for public inspection.

The general disclosure standard for a Hong Kong prospectus is that it must contain such particulars and information as are necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management and prospects of the company, its profits and losses, and rights attaching to the securities offered.

The directors are jointly and severally liable for the accuracy of the information set out in the Hong Kong prospectus, and are required to confirm that, to the best of their knowledge and belief, after all reasonable inquiry, the Hong Kong prospectus is accurate and complete in all material respects, not misleading or deceptive, and does not omit any facts that would result in the Hong Kong prospectus being misleading. Any misstatement in, or omission from, the Hong Kong prospectus may attract civil liabilities pursuant to the CO, the SFO, tort and contract law, as well as criminal liabilities pursuant to the CO, the Theft Ordinance and the SFO.

III THE OFFERING PROCESS

i General overview of the IPO process

Most Hong Kong IPOs, or at least those raising a material level of funds, are comprised of a Hong Kong public offer (HKPO) tranche to retail investors in Hong Kong and an international placing tranche to institutional investors, often sold into the United States and to US investors outside the US, pursuant to exemptions from registration under Rule 144A and Regulation S of the US Securities Act of 1933, as amended. The international tranche is conducted by way of a book-built offering led by the company's investment banks.

The HKPO is conducted on the back of a Hong Kong prospectus (which must be issued in both English and Chinese languages) and corresponding English and Chinese application forms, which are distributed to the public through one (or more) retail banks in Hong Kong engaged by the issuer for such purposes. For the international tranche, an offering circular will be prepared that is typically comprised of the Hong Kong prospectus, surrounded by a 'wrap' containing certain summary terms, risk factors and other disclosures that are specific to US or other international investors.

Practice Note 18 of the Listing Rules (PN18) dictates that the minimum initial allocation to the HKPO must be 10 per cent of the total number of shares offered in the IPO, and that up to an additional 40 per cent of the total shares offered under the IPO must be 'clawed back' to the HKPO from the international placing tranche in the event of

over-subscription by public investors under the HKPO (thus, for particularly ‘hot’ IPOs, the Hong Kong public may end up being allocated 50 per cent of the deal; although, for very large IPOs, it is possible to apply to the HKEx for relaxation of the PN18 requirements).

An investor can only receive shares either in the international placing or the HKPO, but not both. Alternatively, where demand under the HKPO does not meet the initial 10 per cent offered, the shortfall may be reallocated to the international placing tranche.

A pervasive feature of Hong Kong IPOs is cornerstone investors, who are either strategic or financial investors that agree in writing to subscribe for a fixed dollar amount of shares as part of the international placing tranche shortly prior to the bulk-printing of the offering documents at the IPO price (i.e., the price for the shares offered to the public in Hong Kong). Most sizeable IPOs in recent years have had a substantial (20 per cent to 50 per cent) part of their international placing tranche acquired by cornerstone investors; for example, the SoftBank Vision Fund subscribed for US\$500 million of the US\$1.53 billion in shares available in ZhongAn Online P&C Insurance’s 2017 IPO. Appropriate disclosures are required to be made in the offering documents in relation to cornerstone investors, including a brief background summary of the investor and a short description of the terms of the cornerstone agreement. The shares subscribed to by the cornerstone investors are usually subject to a lock-up period of six months following the date of the listing.

Appendix 6 of the Listing Rules (also referred to as the Placing Guidelines) sets out certain rules and restrictions applicable to the international placing, including that:

- a* there should be no fewer than three shareholders for each HK\$1 million of the placing, with a minimum of 100 shareholders;
- b* unless prior written consent from the HKEx is obtained, no allocation is permitted to ‘connected clients’ of the underwriters (i.e., their holding companies, shareholders holding 10 per cent or more of their voting rights, or affiliates), directors or existing shareholders of a company, or their associates or nominee companies, unless the names of the ultimate beneficiaries are disclosed; and
- c* each of the brokers involved in the placing must submit to the HKEx a marketing statement and placee list containing details of placees, and the names and addresses of the beneficial owners of the shares.

Under the Placing Guidelines and Listing Rule 10.04, existing shareholders are not permitted to subscribe for shares under the international placing without prior consent from the HKEx, which is only granted if the offering of shares under the IPO is undersubscribed and the offer price of the shares is fixed at the bottom end of the initial indicative price range (or the shareholders are subscribing for additional shares at IPO pursuant to pre-existing anti-dilution rights).

All Main Board IPOs will also involve an option granted to the underwriters (either by the company or a selling shareholder) enabling the underwriters to require the company to issue (or the selling shareholder to sell) additional shares representing up to 15 per cent of the number of shares initially available under the IPO for the purpose of covering over-allocations in the international placing. The purpose of this overallotment option (or ‘greenshoe option’) is to facilitate the underwriters making stabilisation purchases in the after-market.

It is worth noting that Hong Kong remains a market where investment banks are permitted to issue pre-deal research reports, subject to compliance with certain guidelines with regard to independence and other matters, and that it is common for underwriting banks to issue pre-deal research in advance of an IPO.

Controlling shareholders (holding 30 per cent or more of the company at the time of listing) are subject to a post-IPO lock-up set out in Listing Rule 10.07. This prohibits a controlling shareholder from disposing of any shares in the first six months following an IPO, and a controlling shareholder cannot dispose of any shares in the six months following the first six-month period to the extent that its shareholding falls below 30 per cent. The controlling shareholder can be a single person or a group of persons. Companies are also prohibited from issuing any new shares during the first six-month period, with the limited exception of any shares that may be issued pursuant to management or employee equity ownership schemes, or pursuant to the overallotment option.

ii Considerations for foreign issuers

As noted in Section II.i, one of the principal considerations for foreign issuers in selecting Hong Kong as a listing venue is the potential liquidity and valuation benefits of Hong Kong's accessibility to China-based investors, including pursuant to the Shanghai–Hong Kong Stock Connect and Shenzhen–Hong Kong Stock Connect programmes. Valuations of companies on the Shanghai and Shenzhen exchanges are typically higher than those for comparable companies on non-Chinese exchanges, and there is a perception that Hong Kong listed companies may benefit from the connection to Chinese markets in this regard, together with the added trading volume that the programmes provide.

There are a number of quirks to Hong Kong IPOs that can often challenge foreign issuers. These include:

- a* the need to produce a Chinese-language prospectus for which directors must accept individual personal liability;
- b* the SFC expectation that the content of the Hong Kong prospectus be verified, which is a process that involves a company (and its directors or management) providing written documents to evidence or support all statements in the prospectus (including documents evidencing the educational qualifications and work experience of directors or management);
- c* the requirement that a company register with the Companies Registry of Hong Kong (as a non-Hong Kong company), which necessitates a filing of the residential address and identification document number of each director (that is publicly available);
- d* the intrusive and burdensome diligence and documentary requirements;
- e* the relatively broad discretion exercised by the HKEx to interpret, and grant waivers from, the Listing Rules; and
- f* complex and detailed rules on connected transactions (see Section IV.v).

IV POST-IPO REQUIREMENTS

The Listing Rules set out a number of ongoing compliance requirements, principal among which are the following.

i Ongoing disclosures

Companies must issue announcements if there are any material developments that would reasonably be expected to impact their share price or trading volume ('inside information') as soon as is practicable. This is a legal requirement contained in the SFO, which provides for potential civil and criminal liability for any failures to disclose inside information, or a failure to disclose it promptly. The Listing Rules also set out a number of prescribed situations

where announcements must be made (such as the resignation of directors, issuances of new securities, etc.). Announcements must be issued simultaneously in both English and Chinese, and posted on the websites of the company and HKEx during certain specified posting windows outside market hours.

ii Periodic reporting

Companies must issue annual and interim results announcements within three months and two months, respectively, of the end of their fiscal full and half years. Companies must also issue annual and interim reports to shareholders. Quarterly reporting is optional. Companies are also required to make monthly filings with the HKEx in relation to their share capital and any changes thereto, as well as 'next day' filings upon any new share issuances or share repurchases. Directors are prohibited from dealing in any securities of a company during the 60-day and 30-day periods prior to the issue of annual and interim results announcements, respectively.

iii Disclosure of interest filings

Directors are required to submit filings (within 10 business days of an IPO, and thereafter within three business days) detailing their interests in the share capital (including short positions and options) of a company. Subsequent filings must be made upon the occurrence of any changes. Similarly, other parties must make filings of their interest upon acquiring 5 per cent or more of the issued share capital of a company, and make subsequent filings upon the occurrence of certain changes (primarily if their interest increases or decreases through a full percentage – for example, from 5.4 per cent to 6.2 per cent).

iv Corporate governance requirements

Companies must continue to comply with various corporate governance requirements (including the board composition and committee requirements outlined above). A company secretary meeting certain qualification requirements must also be appointed.

v Notifiable and connected transactions

Transactions (including acquisitions and disposals) above certain size thresholds, or with certain 'connected' parties, are subject to announcement, shareholder approval and reporting requirements.

Broadly speaking, connected transactions are:

- a* transactions between a company (or any of its subsidiaries) and any of its 'connected persons' (which includes directors, CEOs or holders of 10 per cent or more voting rights of the company or any of its subsidiaries, and their respective associates); and
- b* certain other transactions in relation to the acquisition or disposal of an interest in a company, the subscription of shares on favourable terms, financial assistance, options and joint ventures where the counterparty is or could, as a result of the transaction, become a connected person of the company.

The purpose of the connected transactions requirements is to ensure that the interests of shareholders as a whole are taken into account by listed companies and to provide safeguards against connected persons taking advantage of their positions of influence. Connected transactions above certain thresholds require approval from disinterested shareholders in

general meetings, though a variety of exemptions apply (such as exemptions for the provision of financial assistance to a listed company by a connected person, provided that it is on normal commercial terms and no security over the listed company's assets is granted in connection with the financial assistance).

V OUTLOOK AND CONCLUSION

The year 2018 promises to be a watershed for Hong Kong capital markets. The new Listing Rules relating to the listing of biotech companies and companies with WVRs are expected to be effective by June 2018 and presage a wave of biotech and new economy companies listing in Hong Kong, potentially including many of the 'unicorn' technology companies in China and elsewhere.

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