

Capital Markets Review 2022: Doors Open to Chinese Issuers in Hong Kong and the U.S.

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Haiping Li

Partner / Shanghai
86.21.6193.8210
haiping.li@skadden.com

Paloma Wang

Partner / Hong Kong
852.3740.6888
paloma.wang@skadden.com

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One Manhattan West
New York, NY 10001
212.735.3000

42/F Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong
852.3740.4700

Standfirst: After a busy year on the capital markets, Haiping Li and Paloma Wang of Skadden Arps Slate Meagher & Flom LLP take a look at 2022's developments and what the next 12 months may hold.

- There were challenging capital markets conditions worldwide in 2022, with Greater China seeing more than its fair share
- Hong Kong's regulators introduced a number of initiatives aimed at attracting more investors, including more opportunities for those from mainland China
- The U.S. markets also opened, as access to audit papers was relaxed
- In mainland China, a number of regulatory developments also point to easier and swifter listings

2022 saw challenging capital market conditions globally, although issuers in the Greater China region faced a disproportionate share of those challenges. A combination of regulatory restrictions on the technology sector and COVID restrictions in China, together with broader geopolitical tensions, have combined with the macro conditions of economic slowdown and rising inflation and interest rates to put significant pressure on capital markets transactions. Notwithstanding these challenges, however, there are a number of bright spots which present opportunities for Chinese issuers in both Hong Kong and the U.S. There are a number of key developments which can be expected to provide momentum for China's capital markets deals going into 2023.

Hong Kong

Hong Kong Exchanges and Clearing (**HKEX**) have undertaken a number of regulatory initiatives in the past year to make the market more attractive to issuers. These initiatives have increased the paths to listing for Chinese issuers, and have provided new opportunities for companies not previously able to list in Hong Kong.

New listing opportunities for Greater China issuers

HKEX overhauled the regime for listing of overseas issuers at the beginning of 2022 to facilitate dual primary and secondary listings by Greater China issuers.

Greater China issuers are defined by HKEX as issuers that have their "centre of gravity" – including their headquarters, main business operations and assets, controlling shareholders and/or place of central management and control – in Greater China. Historically, Greater China issuers were required to list in Hong Kong by way of primary listing, and were only permitted to undertake a secondary listing if they could demonstrate to HKEX that they were an "innovative company" (i.e., operating an internet or other high-tech business).

However, the position was different for a Greater China issuer which had listed on the New York Stock Exchange, Nasdaq or London Stock Exchange (a "**Qualifying Exchange**") on or before 15 December 2017, referred to as a "**Grandfathered Greater China Issuer**", if the company had weighted voting right (**WVR**) (dual class share) structures or variable interest entity (**VIE**) arrangements that did not comply with HKEX's rules. Such companies could previously only undertake a secondary listing in Hong Kong.

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Under the revised rules, any overseas company, including a Greater China issuer, may apply for a secondary listing in Hong Kong regardless of whether their business is “innovative”, provided they meet one of the following two tests:

- a HK\$3 billion market capitalization with a track record of good regulatory compliance for five full financial years on one of the above Qualifying Exchanges (for Greater China issuers) or on a wider range of recognized overseas exchanges (for non-Greater China issuers); or
- a HK\$10 billion market capitalization with a track record of good regulatory compliance for two full financial years on a Qualifying Exchange.

The compliance track record requirements may be waived if the company is “well-established” and has a market capitalization significantly larger than HK\$10 billion.

Companies with a WVR structure seeking a secondary listing will still be required to meet the “innovative company” requirements, as well as the more stringent compliance track record and market capitalization/revenue tests as those required for a dual-primary listing (see below).

In addition, Grandfathered Greater China Issuers as well as non-Greater China issuers with noncompliant WVR and/or VIE structures can apply directly for a dual-primary listing in Hong Kong if they:

- are able to demonstrate that they are an “innovative company”;
- have a track record of good regulatory compliance of at least two full financial years on a Qualifying Exchange; and
- have (i) a market capitalization of at least HK\$40 billion; or (ii) a market capitalization of at least HK\$10 billion and revenue of at least HK\$1 billion for the most recent financial year.

HKEX has seen significant success in attracting Chinese companies with overseas listings to undertake secondary or dual-primary listings in Hong Kong, and these new rules are expected to add momentum to that trend.

HKEX seeks to attract specialist technology companies

In a market consultation issued in October 2022, HKEX proposes to facilitate listings by “specialist technology companies” with their principal business in one of a number of specified industries within the following sectors:

- next generation information technology;
- advanced hardware;
- advanced materials;

- new energy and environmental protection; and
- new food and agriculture technologies.

The specified industries broadly mirror those permitted to list on Shanghai’s STAR Market, as HKEX responds to the competitive challenge posed by their mainland rival.

HKEX proposes to permit listings by specialist technology companies with a minimum revenue of HK\$250 million in the most recent audited financial year (a **Commercial Company**) as well those which do not meet this revenue threshold, including pre-revenue companies (a **Pre-Commercial Company**). The listing requirements for each category of company will be as follows:

Listing Requirement	Commercial Company	Pre-Commercial Company
Market capitalization	HK\$8 billion at time of listing	HK\$15 billion at time of listing
R&D track record	Engaged in R&D for at least 3 financial years	
Annual R&D expenditure during track record period	At least 15% of total operating expenditure	At least 50% of total operating expenditure

Specialist technology companies will need to have received meaningful third party investment from sophisticated independent investors, being a company or fund with HK\$15 billion under management, or HK\$5 billion if investing primarily in specialist technology, or a key player in a relevant upstream/downstream industry. The company must have:

- at least two sophisticated independent investors each holding at least 5% of the company at least 12 months prior to applying for listing; and
- aggregate investment from all sophisticated independent investors at the time of listing on a sliding scale from 10% through to 25%, depending on the market capitalization of the company and whether it is Commercial or Pre-Commercial.

HKEX proposes that controlling shareholders, pre-IPO sophisticated independent investors, executive directors, senior management and key operational/technical personnel be subject to post-IPO lockups of 12 months (for a Commercial Company) or 24 months (for a Pre-Commercial Company). The scope and length of these lock-ups is particularly broad, and may be both a disincentive and competitive disadvantage for issuers under the proposed regime.

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HKEX is expected to release its consultation conclusions and finalise the new rules in early 2023.

Door opens to SPACs in Hong Kong

Hong Kong's highly-anticipated regime to permit the listing of Special Purpose Acquisition Companies (**SPACs**) also came into effect at the beginning of 2022. HKEX's rules are heavy on investor protection measures and present fairly significant hurdles for SPAC promoters and De-SPAC targets compared to other jurisdictions.

Among the key features to protect investors are:

- Only professional investors are permitted to subscribe for or trade SPAC securities. To avoid undue speculation in SPAC shares, they are required to trade in board lots of at least HK\$1 million per lot.
- SPACs are required to ring-fence 100% of IPO proceeds, and upon redemption refund investors their pro rata share of the full amount.
- SPACs are required to offer investors redemption opportunities, including upon any vote for a De-SPAC transaction.

There is a high bar for SPAC promoters, including the requirement that at least one promoter be a firm licensed by the SFC for asset management (type 9) or corporate finance advisory (type 6) regulated activity and hold 10% of SPAC promoter shares. HKEX retains broad discretion to approve the suitability of SPAC promoters based on their experience, character and integrity.

SPAC IPOs are subject to stringent fundraising and distribution requirements, including:

- a minimum offering size of HK\$1 billion; and
- distribution to at least 75 professional investors, of which at least 20 must be institutional (not individual) professional investors who must hold at least 75% of the SPAC securities.

SPACs are required to announce a proposed De-SPAC transaction within 24 months of IPO, and complete a De-SPAC transaction within 36 months of IPO, subject to a six-month extension of either deadline with shareholder and HKEx approval.

From the point-of-view of De-SPAC targets, the regime presents hurdles which may make Hong Kong-listed SPACs less attractive to targets than SPACs listed elsewhere.

De-SPAC targets must have a fair market value of at least 80% of funds raised by the SPAC. In combination with the SPAC minimum fund raise requirement, this means that only targets

with a valuation of upwards of HK\$800 million could pursue a De-SPAC transaction in Hong Kong.

HKEX will treat any De-SPAC transaction as a new listing application: The newly merged company must meet all listing requirements, a sponsor must be appointed and conduct due diligence to IPO-standard, and the listing document must meet prospectus standards and be subject to full vetting by HKEX. The time and process required for a target to go public via a De-SPAC transaction will therefore be comparable to that required for a traditional IPO.

SPACs are also required to conduct a PIPE (private investment in public equity) share placing to institutional investors simultaneous with their De-SPAC transaction. The size of the mandatory PIPE investment is based on a sliding scale, with a minimum PIPE investment of 25% for a de-SPAC valuation of less than HK\$2 billion to as low as 7.5% for a de-SPAC valuation of HK\$7 billion or more. At least 50% of the PIPE investment must be contributed by at least three sophisticated investors (defined as investors with assets under management of at least HK\$8 billion).

Perhaps partly as a result of the restrictive regulatory framework, as well as weakening sentiment globally for SPACs, there has been limited uptake under Hong Kong's new SPAC regime, with only four successful SPAC IPOs on HKEX during 2022. None of those companies has announced a De-SPAC transaction as yet.

United States

Path for U.S. listings is open for China-based issuers

The past year saw a number of new U.S. listings by China-based issuers, including companies headquartered in Hong Kong, through both traditional IPOs and de-SPAC transactions. Among such newly listed issuers are companies with auditors that are accounting firms identified by the Public Company Accounting Oversight Board (**PCAOB**) in December 2021 as those that the PCAOB is unable to inspect or investigate completely. On Dec. 15, 2022, the PCAOB announced that it had secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong, and had vacated the previous determinations to the contrary. This is a landmark development that signals the end to the decade-old controversy surrounding access to accounting audit papers between China and the United States. Over 100 China-based issuers listed on U.S. stock exchanges no longer face foreseeable delisting risk. Therefore, prospective IPO issuers can continue to consider the U.S. capital market for their public listings.

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For the U.S. side

On July 31, 2021, the U.S. Securities and Exchange Commission (“SEC”) Chair Gary Gensler issued a statement on China-based issuers that heralded intensive vetting of their registration statements. The Staff of the SEC later summarized its views by publishing the sample letter to China-based issuers in December 2021. Between the Q3 2021 and Q1 2022, few if any China-based issuers with auditors based in mainland China or Hong Kong were able to complete their U.S. listings, regardless of whether they were IPOs or de-SPAC transactions.

Beginning in Q2 2022, the U.S. listing market began to thaw for China-based issuers, including companies headquartered in Hong Kong. De-SPAC transactions led the pack, followed by traditional IPOs, in clearing SEC comments and completing listings.

The SEC Staff has been consistent with its past practice in terms of the timeline for reviewing registration statements. In other words, there has not been any evident delay in issuing comment letters, despite the intensive vetting of China-based issuers.

Unlike issuers with auditors previously identified by the PCAOB, China-based companies that have engaged (non-Big Four) accounting firms not located in mainland China or Hong Kong have witnessed a less obvious hiatus in their U.S. listings during the past 18 months. However, major headwinds face such companies, which typically are smaller in size compared with issuers that have engaged Big Four firms. First, the SEC Staff has signaled that it is closely scrutinizing arrangements where China-based issuers engage non-local auditors. SEC Acting Chief Accountant Paul Munter issued a statement on this topic on Sept. 6, 2022. Second, Nasdaq has reportedly halted IPOs of small Chinese companies as it probes stock volatility of certain smaller China-based companies. In addition, issuers based in China that have engaged or plan to engage non-local accounting firms as principal auditors should ensure that such arrangement complies with all relevant PCAOB rules.

If there is one key takeaway from 2022 it is that the U.S. capital market operates under a disclosure-based regime, and this is still equally applicable to China-based issuers. Such a disclosure-based system is a core competitive advantage compared with other major capital markets around the world. In addition, the U.S. capital market provides unrivalled liquidity, unmatched depth of institutional investors and a transparent regulatory environment. U.S.-listed status also paves the way for expedited dual listing in a number of popular capital market destinations globally, including Hong Kong. As such, the U.S. remains an attractive option for Chinese entrepreneurs.

Environmental, social and governance (ESG) continues to be a hot topic. Looking ahead, China-based issuers should prepare for enhanced ESG disclosure requirements in the U.S., a trend echoed by regulators in other major capital markets, including Hong Kong. While no final rule has been adopted in this regard for foreign private issuers, China-based companies should preemptively strengthen internal and external ESG reporting capabilities because of the inherent complexities involved.

On the China side

On Dec. 28, 2021, the Cyberspace Administration of China, together with certain other PRC governmental authorities, jointly released the revised *Cybersecurity Review Measures* (网络安全审查办法), which took effect on Feb. 15, 2022. Pursuant to the measures, operators of network platforms seeking listings outside of China that are in possession of more than one million users’ personal information must apply for a cybersecurity review. The review is carried out by the China Cybersecurity Review Technology and Certification Center (CCRC).

The Chinese government has stated on numerous occasions that it is supportive of China-based companies seeking listings outside of China. The CCRC has been carrying out cybersecurity reviews in a timely and cooperative manner, with clear decisions rendered. Issuers should initiate cybersecurity review applications, if deemed necessary, during the early stage of the transaction process, in order to minimize the impact of the review on the deal timetable. The SEC Staff has requested that issuers disclose the basis for their conclusions regarding the applicability of the cybersecurity review, and PRC legal counsel should be prepared to advise on this matter.

On Dec. 24, 2021, the China Securities Regulatory Commission (CSRC) released the

State Council, Provisions for the Administration of Overseas Offering of Securities and the Listing Thereof of Domestic Enterprises (Draft for Comments) (国务院关于境内企业境外发行证券和上市的管理规定 (草案征求意见稿)) and the

China Securities Regulatory Commission, Measures for the Administration of the Record Filing of Overseas Offering of Securities and the Listing Thereof of Domestic Enterprises (Draft for Comments) (中国证券监督管理委员会境内企业境外发行证券和上市备案管理办法 (征求意见稿)), both of which were open for public comments until Jan. 23, 2022. Under these draft rules, a filing-based regulatory system would be applied to “indirect overseas offering and listing” of PRC domestic companies. It remains uncertain when, if ever, the final versions of these new provisions and measures will be issued and take effect.

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Leading PRC law firms generally agree that because the above-mentioned CSRC draft provisions and measures have not been adopted, there is currently no filing requirement with the CSRC. However, it would be advisable for issuers to discuss with their underwriters and legal advisors soon after deal kick-off to assess whether a voluntary notification to the CSRC should be made. The CSRC has been helpful in responding to such inquiries.