

# Valuation Insights

## Greater China Edition

FIRST QUARTER 2020

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# Hong Kong Stock Exchange Proposes Rules on Weighted Voting Rights for Corporate Shareholders

In a move to resolve the debate around Weighted Voting Rights (WVR) in Hong Kong, the Stock Exchange of Hong Kong Limited (HKEx) published a consultation paper on allowing companies to hold shares with extra voting rights for new Hong Kong listings.<sup>i</sup>

When WVR was first raised in April 2018, HKEx only allowed it for individuals who were materially responsible for the growth of an innovative company.<sup>ii</sup> The consultation paper, released on January 31, seeks to allow corporate shareholders to enjoy WVR as well.

As proposed by the paper, a corporate shareholder with WVR must itself be listed on the HKEx, the New York Stock Exchange (NYSE), Nasdaq or the London Stock Exchange's main market. The corporate shareholder must also fulfill the following conditions:

- It must be either an innovative company itself, have a track record of investment and contributions in innovative companies, or have business experience in one or more emerging and innovative sectors
- It must have an expected market capitalisation of at least HKD 200 billion at the time of listing
- It must hold at least 30% of the economic interest in the listed company, and provide a contribution "that cannot be easily replicated or substituted by other means"

The listing applicant and corporate shareholder will need to show that they belong to the same "ecosystem" of companies. The ecosystem should have developed around a technology, platform, or set of core products or services; and should be owned or operated by the corporate shareholder.

Conscious that an "evergreen" corporate WVR structure might raise an undue amount of controversy, the consultation paper proposes several investor safeguards, including:

- A voting right ratio that never exceeds five times the voting power of ordinary shares (unlike WVR limits for private shareholders that go as high as ten times the voting power of ordinary shares)

- A permanent lapse to WVR if the corporate shareholder's contribution to the listed company ends or is suspended for more than 12 months
- A sunset provision that ends WVR automatically after 10 years (other shareholders can vote to continue the WVR structure after the 10-year period, renewing arrangements for further five-year periods)

HKEx believes these recommendations can attract listings from more innovative companies, while diversifying an exchange with an overrepresentation of financial services and real estate companies.

Investment bankers and IPO advisors have expressed concern that if corporate shareholders aren't accommodated on WVR, Hong Kong's capital market will face more difficulty in attracting listings from innovative companies. Tencent Music chose to list on NYSE in 2018 instead of HKSE, because the American exchange offered corporate WVR structures that the latter lacked.<sup>iii</sup>

On the other hand, some stakeholders have expressed concern that corporate WVR goes against Hong Kong's long-honoured tradition of "one share, one vote".<sup>iv</sup>

The consultation period for the paper will end on May 1, 2020. Interested respondents may download the consultation paper here: [Consultation Paper - Corporate WVR Beneficiaries \(HKEX.com.hk\)](https://www.hkex.com.hk/News/News-Release/2020/200131news?sc_lang=en).

i. "Exchange Publishes Consultation Paper on Corporate WVR Beneficiaries." HKEX.com.hk. Hong Kong Exchanges and Clearing Limited, January 31, 2020. [https://www.hkex.com.hk/News/News-Release/2020/200131news?sc\\_lang=en](https://www.hkex.com.hk/News/News-Release/2020/200131news?sc_lang=en).

ii. "Hong Kong's Listing Regime Enters New Era, Featuring Emerging and Innovative Firms." HKEX.com.hk. Hong Kong Exchanges and Clearing Limited, April 24, 2018. [https://www.hkex.com.hk/News/News-Release/2018/180424news?sc\\_lang=en](https://www.hkex.com.hk/News/News-Release/2018/180424news?sc_lang=en).

iii. John, Alun. "UPDATE 1-Hong Kong exchange proposes allowing corporate weighted voting rights." Reuters.com. Reuters, January 31, 2020. <https://www.reuters.com/article/hkex-wvr/update-1-hong-kong-exchange-proposes-allowing-corporate-weighted-voting-rights-idUSL4N2A03JZ>.

iv. Yiu, Enoch. "Hong Kong exchange, spurred by Alibaba, Xiaomi listings, proposes expansion of IPO reforms to attract more tech giants." South China Morning Post. South China Morning Post Publishers Ltd., January 31, 2020. <https://www.scmp.com/business/banking-finance/article/3048471/hong-kong-exchange-spurred-alibaba-xiaomi-listings>.

## SFC Issues Circular for PE Firms Seeking Licence

On January 7, 2020, the Securities and Futures Commission of Hong Kong (SFC) issued a “Circular to Private Equity Firms Seeking to be Licensed,” clarifying the licensing obligations of PE firms conducting business in Hong Kong.<sup>i</sup>

Until very recently, private equity (PE) fund managers in Hong Kong had some leeway in creatively interpreting Securities and Futures Ordinance (SFO) rules. Some could argue (based on generous readings of the rules) that their activities exempted them from the need to be licensed for Type 9 regulated activities (RA9) – for example, PE fund managers overseeing portfolios of unlisted securities.

The Circular puts an end to this, by drawing clear lines on who needs to be licensed for RA9, and who doesn't. Under the new rules, PE firms seeking to be licensed in Hong Kong under Part V of the Securities and Futures Ordinance (SFO) need to take the following factors into account:

- General partners are generally required to be licensed for Type 9 regulated activity (RA9) if it conducts fund management business in Hong Kong that amounts to asset management.
- To be licensed for RA9, PE firms must demonstrate full discretionary investment authority with respect to the funds they manage.
- Members of an investment committee in PE firms licensed for RA9, if shown to play a dominant role in making investment decisions, must be licensed as representatives and must be approved as responsible officers where appropriate.
- PE firms utilising special purpose vehicles (SPVs) for investment holding purposes must secure a license for RA9 if its underlying investments held through such SPVs (or shares or debentures of the SPVs themselves) fall within the definition of “securities” under the SFO.
- If a PE firm offers investment opportunities to other persons, whereby they may enter into securities transactions alongside the PE fund, the firm is generally required to be licensed for Type 1 regulated activity of dealing in securities (RA1).

- As fund marketing activities fall within the definition of “dealing in securities” as defined in the SFO, a PE firm doing business in such activities shall generally be required to be licensed for RA1.
- The SFC will adopt a “pragmatic approach” in assessing whether a responsible officer applicant of a PE firm has the required relevant industry experience to satisfy competency requirements—a broad range of experience will be recognised, so long as the applicants demonstrate that their experience is relevant to their proposed duties.

PE firms may use the Circular as a reference to review their operations, and to determine whether they may need to obtain a licence from the SFC. One thing is clear: it's now much harder for fund managers to argue that they need no licence at all.

If you need assistance forecasting the impact this Circular might have on your operations, look to Duff & Phelps.

Duff and Phelps can help your firm meet the Circular's recommendations, as well as other regulatory and compliance requirements that may cause concern. Our [Portfolio Valuation Services](#) offers guidance to PE firms on portfolio valuation best practices, including practical guidance on evolving industry standards.

i. “Circular to private equity firms seeking to be licensed.” Securities & Futures Commission. Securities & Futures Commission, January 7, 2020. <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC2>.



# U.S.-China Trade Deal Phase One to Impact Intellectual Property and Tech Transfer

On January 15, 2020, U.S. President Donald Trump and China's Vice Premier Liu He signed a "Phase One" U.S.-China trade deal in the East Room of the White House.

The 96-page "Economic and Trade Agreement Between the United States of America and the People's Republic of China" resolves many points of contention between China and the U.S. in the areas of currency, dispute resolution, trade in food and agriculture products, intellectual property (IP) and technology transfer.<sup>i</sup>

The Agreement arguably makes the most progress where IP and technology transfer are concerned. In brief, China commits to stronger legal protections for American IP, and to changing its policies on forced technology transfer. This resolves a long-held complaint among American companies, especially those in the tech sector.

Chapters One and Two deal with IP and technology transfer, respectively, reaching the following conclusions:

**Intellectual Property.** The Agreement devotes 18 pages (up to a fifth of its entire length) to IP protection, including commitments on protecting trade secrets, pharmaceutical-related IP, trademarks, patents, geographical indications, e-commerce infringement and measures against pirated/counterfeit goods.

To address U.S. businesses' long-held complaints that trade secrets have enjoyed insufficient protection under Chinese law, the Agreement provides stronger measures to protect trade secrets and punish trade secret theft, such as criminal penalties for willful trade secret misappropriation.

Under the Agreement, China must publish an action plan explaining how they will meet their IP obligations. And as China increases IP enforcement actions in a number of areas, the country is obliged to publish data on their impact.

**Technology transfer.** American companies have long decried China's practice of forcing American companies to transfer technology in exchange for access to the Chinese market. The U.S. perceives this as an underhanded method to secure American IP, with the intent of developing competing products and industries based in China.

The Agreement now holds that any transfer of technology or licenses between people of each country must be voluntary: companies in China should operate "without any force or pressure from the other Party to transfer their technology to persons of the other Party."

Consequently, U.S. companies will no longer be obliged to share technology with local joint-venture partners, or license technology at bargain-basement prices in exchange for the right to do business in China.

China has already made significant steps towards improving its enforcement regime over foreign IP. In 2019, for instance, a new trademark law prohibited bad-faith trademark filings by trademark squatters, and increased punishments for trademark infringement.<sup>ii</sup>

If the IP and technology transfer provisions in the Phase One trade deal affect your business prospects in China, Duff & Phelps can offer objective and independent assessment of the Agreement's impact. Advisors from our [Valuation Advisory Services](#) and [Transfer Pricing practice](#) can help you plan ahead, so any consequences won't catch you unawares.

i. "Economic and Trade Agreement Between the Government of the United States Of America and the Government of the People's Republic of China." Office of the United States Trade Representative. Office of the United States Trade Representative, January 16, 2020. [https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic\\_And\\_Trade\\_Agreement\\_Between\\_The\\_United\\_States\\_And\\_China\\_Text.pdf](https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf).

ii. Zhang, Zoey. "China's New Trademark Law in Effect from November 1." China Briefing. Dezan Shira & Associates, November 19, 2019. <https://www.china-briefing.com/news/chinas-new-trademark-law-effect-november-1-2019/>.



# New Rules Expand CFIUS Jurisdiction Over Foreign Investment in the U.S.

On January 13, 2020, the U.S. Department of the Treasury finalised two sets of regulations covering implementation of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA).<sup>i</sup>

The regulations were issued on behalf of the Committee on Foreign Investment in the United States (CFIUS); one pertains to certain covered real estate transactions, and the other pertains to all other covered transactions.

All told, the new rules considerably expand CFIUS's jurisdiction over foreign investments in the U.S. The finalised regulations clarify the Treasury's interpretation of covered minority investments, covered real estate transactions, excepted investors and mandatory filings for foreign government-related investments.

They are substantially similar to proposed rules published for public comment on September 17, 2019 and are scheduled to come into effect on February 13, 2020.

**Real Estate:** *Provisions Pertaining to Certain Transactions by Foreign Persons Involving Real Estate in the United States* (31 C.F.R. part 802) was established to implement CFIUS's authority over certain real estate transactions within the U.S., particularly those within close proximity to certain specified military or U.S. government installations.

The final regulations add exceptions for leases or concessions in covered ports—foreign air carriers are exempt only for transactions covering the lessor's activities as a foreign air carrier; and retailers are exempt for the purpose of selling consumer goods or services to the public.

**Covered Investments:** *Provisions Pertaining to Certain Investments in the United States by Foreign Persons* (31 C.F.R. part 800) were revised to clarify CFIUS's jurisdiction over small, non-controlling investments (referred to as "covered investments") in "TID U.S. businesses" (short for **T**echnologies, **I**nfrastructure and **D**ata).

Consistent with the new mandatory filing regime introduced in the CFIUS pilot programme, filing will be required for most covered investments or transactions that result in foreign control of a TID U.S. business involved in certain critical technologies and are used or designed to be used in 27 specified industries.

"Genetic information" is also more clearly defined as part of "sensitive personal data", exempting data provided for research purposes while covering information in an individual's genetic tests.

While the revised regulations go a long way in clarifying the originally proposed rules, certain issues remain to be resolved. CFIUS has yet to define certain essential terms ("principal place of business", among others), specify filing fees, and publish changes to mandatory filings for critical technologies.

Any Greater China-based investors and U.S.-based businesses must consider cross-border transactions more carefully, with an eye towards CFIUS's role in supervising transactions and enforcing relevant regulations.

i. "Treasury Releases Final Regulations to Reform National Security Reviews for Certain Foreign Investments and Other Transactions in the United States." U.S. Department of the Treasury. U.S. Department of the Treasury, January 13, 2020. <https://home.treasury.gov/news/press-releases/sm872>.



# China Welcomes Wholly Foreign-Owned Futures Companies in 2020

In another step signalling the increasing openness of China's financial services industry to foreign investment, foreign shareholding restrictions in Chinese futures companies were removed on January 1, 2020.

The move had been announced in an October 11, 2019 press conference by the China Securities Regulatory Commission (CSRC), which released the time frame for the removal of limits on foreign ownership in domestic financial services entities.<sup>i</sup>

A similar lifting of restrictions will be granted for fund management companies (FMCs) on April 1, 2020, and for securities companies by December 1 of the same year.

At present, only one foreign-direct-invested futures company operates within China: Guangdong-based JP Morgan Futures, with JP Morgan holding 49% equity interest. In January, JP Morgan applied to the CSRC for the right to purchase a majority stake in the company, though the extent of the stake is as yet undisclosed.<sup>ii</sup>

China's futures market has largely been underdeveloped and isolated, due to the restrictive regulatory regime overseeing futures companies' business activities. Foreign investment activity has consequently overlooked this sector, until very recently.

Initiatives by the Chinese government, from expanding the range of products available to relaxing regulations, have since encouraged an ongoing expansion of China's futures market in recent years.

CSRC Vice President Mr. Fang Xinghai explained last December that the year 2019 saw the debut of 14 futures products, a record for a single year, adding to a total of 75 listed products on offer.

China has opened up four commodities futures contracts to foreign investors—crude oil and technically specified rubber (TSR) 20 on the Shanghai International Energy Exchange; iron ore on the Dalian Commodity Exchange; and purified terephthalic acid (PTA) on the Zhengzhou Commodity Exchange.<sup>iii</sup>

In the next two years, the Shanghai Futures Exchange may open non-ferrous metals futures contracts to overseas investors.<sup>iv</sup>

Qualified foreign institutional investors (QFII) were previously allowed to trade stock index futures for hedging purposes. A draft of rules governing investments by QFIIs and RMB Qualified Foreign Institutional Investors (RQFII) may expand these investors' investment scope to include financial futures and commodity futures.<sup>v</sup>

Normal trading of stock index futures has recovered since a 2015 market crash—as of the end of October 2019, China's futures investment and trading reached a total market capital of RMB 545 billion, increasing 25.58% over the beginning of the year. The futures market also reported 3.185 billion transactions in that time, with a total transaction value of RMB 235.43 trillion yuan, up 30% and 37.4% year-on-year respectively.<sup>vi</sup>

The removal of foreign shareholding restrictions in Chinese futures companies may have serious effects on the valuation of your company, particularly if it seeks to acquire sole ownership of a domestic futures firm under the new rules. Look to Duff & Phelps' [Valuation Advisory Services](#) for an objective and independent assessment of its impact.

i. "Removal of foreign ownership limit in foreign-invested futures companies." China Securities Regulatory Commission. China Securities Regulatory Commission, October 15, 2019. [http://www.csrf\\_en/newsfacts/release/201910/t20191015\\_364441.html](http://www.csrc.gov.cn/pub/csrf_en/newsfacts/release/201910/t20191015_364441.html).

ii. Weinland, Don. "JPMorgan applies to take control of China futures joint venture." *Financial Times*. The Financial Times Ltd., January 9 2020. <https://www.ft.com/content/97af1f1a-3293-11ea-9703-eea0cae3f0de>.

iii. Li Xia. "China launches natural rubber futures to overseas investors." *Xinhuanet*. Xinhua, August 13, 2019. [http://www.xinhuanet.com/english/2019-08/12/c\\_138303307.htm](http://www.xinhuanet.com/english/2019-08/12/c_138303307.htm).

iv. Meng Meng. "China's ShFE aims to open non-ferrous futures to foreign investors within two years." Reuters. Reuters, May 28, 2019. <https://www.reuters.com/article/us-china-commodities-futures/chinas-shfe-aims-to-open-non-ferrous-futures-to-foreign-investors-within-two-years-idUSKCN1SY03I>.

v. "CSRC Solicits Public Comments on the Measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors and RMB Qualified Foreign Institutional Investors (Consultation Paper) and the Supporting Rules." China Securities Regulatory Commission. China Securities Regulatory Commission, January 31, 2019. [http://www.csrf.gov.cn/pub/csrf\\_en/newsfacts/release/201901/t20190131\\_350605.html](http://www.csrf.gov.cn/pub/csrf_en/newsfacts/release/201901/t20190131_350605.html).

vi. Zhan Jing. "证监会副主席方星海：12月将有5个新品种登陆期货市场." *Xinhuanet*. Xinhua, November 30, 2019. [http://www.xinhuanet.com/2019-11/30/c\\_1125293048.htm](http://www.xinhuanet.com/2019-11/30/c_1125293048.htm).

# International Valuation Standards Council Issues IVS 2020 Update

As of January 31, 2020, the latest edition of the International Valuation Standards (IVS), titled IVS 2020, has taken effect—replacing its earlier 2017 edition.<sup>i</sup>

Promulgated by the International Valuation Standards Council (IVSC), the latest edition represents a landmark in the IVSC's goal of harmonising worldwide valuation practice. Guidance from IVS 2020's contents will help valuation professionals ensure consistency, transparency and confidence in their valuations, with positive effects on investment decisions, financial reporting and market stability.

IVS 2020 consists of five general standards, six asset standards and a standard on non-financial liabilities. The general standards offer guidance for all valuation assignments, while the asset standards include requirements related to specific types of assets.

The 2020 edition differs from the 2017 edition in the following areas:

- A new chapter, "IVS 220 Non-Financial Liabilities", has been added<sup>ii</sup>
- Key updates have been introduced in relation to "development property" (IVS 410), "limitations" (IVS 102) and "valuation models" (IVS 105)
- Technical revisions consulted on between 2018 and 2019 have been incorporated into the new edition
- The IVS glossary now includes new terms, and provides additional clarifications, reflecting the IVSC's continuing efforts to update valuation standards, terminology and definitions.

For professionals seeking further clarity on the changes, IVSC has published a "red-line" version that allows readers to compare changes from IVS 2017. To view this document, visit the International Valuation Standards website ([ivsonline.org](http://ivsonline.org)) and subscribe or sign in for access.

IVS 2020 was drafted by the IVSC's independent technical boards, and published after extensive consultation with professional organisations, regulatory authorities, standard setting organisations and other stakeholders.

Should you require any clarity on the effects the new IVS 2020 may have on any valuation issues affecting your company, look to Duff & Phelps. Our [Portfolio Valuation Services](#) offers guidance on portfolio valuation best practices, including practical guidance on evolving industry standards. And our [Compliance and Regulatory Consulting Practice](#) can help with any other regulatory and compliance requirements that may cause concern.

i. "International Valuation Standards Updated." IVSC. IVSC, 2020. <https://www.ivsc.org/news/article/ivs-updated>

ii. "Consultation launched: IVS 220 Non-Financial Liabilities." IVSC. IVSC, 2019. <https://www.ivsc.org/news/article/consultation-launched-ivs-220-non-financial-liabilities>.



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