

Hong Kong's new bookbuilding, placing requirements

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The Securities and Futures Commission of Hong Kong (SFC) is introducing new rules on conduct expected of capital market transactions that take effect on 5 August 2022.

The SFC requirements adopt key proposals from the consultation process for its Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions, and Sponsor Coupling Proposal, announced in October 2021. The author highlights here certain important new requirements.

CODE OF CONDUCT

Only licensed or registered persons may engage in regulated activities in Hong Kong, which include sponsoring IPOs and bookbuilding/placing in a share or debt offering. In conducting such activities, they must comply with the revised Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

CAUSE FOR CONCERN

While syndicate members in Hong Kong IPOs are given more leadership titles, responsibilities over key activities become less defined among the many leaders.

Also, the SFC notes increasing concern over the behaviour of intermediaries engaged in IPOs not in line with maintaining a healthy capital market, or possible conflicts of interest. For example, firms marketing the offering to investors without a mandate from the issuer, and subsequently convincing the issuer to accept them as syndicate members.

In this case, the issuer provides fee incentives at a late stage, further bringing about last-minute scrambles for orders and fees. Syndicate leaders thus have much less control over the whole bookbuilding and share allocation exercise at the last critical phase of the IPO.

For IPO sponsorship, the SFC also notices that fees are currently not aligned with sponsors' costs and responsibilities. Based on its analysis of 99 IPOs listed from January to September 2020, the average sponsor fee was HKD6.3 million (USD804,000) and the average underwriting fixed fee was HKD43.9 million. This causes concerns over sufficient effort by sponsors in conducting due diligence on the issuers.

NEW REQUIREMENTS

The SFC will adopt proposals set out in the Consultation Conclusions by introducing new paragraphs 17.1A and 21 in the code. The new requirements specify:

- Regulated activities include: (1) bookbuilding; (2) marketing and distribution of share or debt securities (placing activities); and (3) advising, guiding and assisting the issuer for the above-mentioned. Mere market sounding and settlement are not included.
- The requirements apply to both share and debt offerings, namely equity and debt capital market transactions. They cover IPOs with offerings of new and issued shares, and also listed issuers' offerings of new shares (including by way of top-up subscription and placing) if bookbuilding is involved. Debt securities, whether listed in Hong Kong or not, are covered if the bookbuilding is conducted in Hong Kong.
- An "overall co-ordinator" (OC) is defined as a syndicate capital market intermediary (CMI) conducting overall management of the offering, co-ordinating the bookbuilding and placing activities, advising the issuer on the offer price, and exercising discretion in share reallocation and over-allotment options.
- Each syndicate CMI should be appointed by the issuer under a written agreement (including the fixed fee payable to the CMI and payment schedule) before it conducts any bookbuilding or placing activities.
- At least two months before listing application submission for a Main Board IPO, the issuer should appoint at least one OC (or its group company) acting as an independent sponsor to the IPO. This "sponsor coupling" requirement may help ensure quality sponsor work.
- Not later than two weeks after listing application submission (GEM or Main Board), the issuer should appoint all OCs (including their fixed fees and payment schedules). The OC must submit to the SFC list of all OCs with fixed fee payable to each, total fees, and the fixed and discretionary fee split ratio at least four clear business days before the Listing Committee Hearing, and notify the SFC if there are any material changes.
- There is no specific timeframe for appointing OCs in a non-IPO transaction.
- The OC is required to provide guidance to the issuer about the market's fee split practice.
- A CMI should not offer or pass any rebate to any investor. It should disclose the rebate details to the issuer, the OC, its target investors and the non-syndicate CMIs appointed by it.
- When placing orders, a CMI should provide to the OC the name and a unique identification number (identity card number) of each investor for orders placed on an omnibus basis and the identities of all other investors, in order to ensure transparency in the bookbuilding process and assist in eliminating duplicate orders.
- Share and debt securities should be allocated on a fair basis. Priority should always be given to satisfying investor clients' orders over the CMI's own proprietary orders (including orders placed for funds and portfolios in which the CMI or its group member has a substantial interest).

The SFC has also issued guidelines to capital market intermediaries involved in placing activities for GEM stocks, which will also take effect on 5 August 2022.

KEY TAKEAWAY

There are many types of share and debt offerings in terms of nature and complexity. A CMI may play different roles in different

offerings. A licensed or registered institute, in taking up the role as a syndicate CMI, should put in place sufficient resources and effective controls to comply with the new requirements and to deal with conflicts of interest.

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