Hong Kong Capital Markets Update

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HKEX's consultation on IPO price discovery and open market requirements

On 19 December 2024, the Stock Exchange of Hong Kong Limited (the "Exchange") published a **consultation paper**[1] ("Consultation") seeking market feedback on proposals to optimise IPO price discovery and open market requirements. The objective of the proposals is to ensure the Exchange's listing mechanism remains attractive and competitive for existing and prospective issuers. In particular, the Exchange proposes to:

(a) Review open market requirements, ensuring issuers will have sufficient shares in public hands that are available for trading at listing, while relaxing certain percentage thresholds which would imply a bar that may be too high in absolute dollar value.

(b) Optimise the price discovery process for IPOs to increase the participation of "price setting" investors, thereby reducing the likelihood of the final offer price being set at a large disparity to the actual trading price when dealing in those shares commence.

List of Key Proposals

Open Market Requirements

1. **calculation of public float** – determine public float percentage by reference to securities of that class only (exclude shares listed outside of Hong Kong)

2. **initial public float** – introduce tiered initial public float thresholds

3. **ongoing public float** – seek views on appropriate ongoing public float requirements, including whether issuers should be allowed flexibility to maintain a lower public float level after listing

4. **free float** – introduce free float requirement for all new applicants:
   (a) market value > HK$50m, representing ≥ 10% of listing shares; or (b) market value >HK$600m

5. **A+H issuers** – reduce minimum threshold of H shares required for A+H issuers to list in Hong Kong to:
   (a) at least 10% of total shares issued; or (b) market value >HK$3B at listing

IPO Price Discovery

6. **cornerstone investment** – seek views on either retaining current six-month lock-up period or implementing "staggered lock-up release" on cornerstone IPO shares

7. **bookbuilding placing tranche** – minimum 50% allocation of offer shares to the bookbuilding place tranche

8. **public subscription tranche** – reduce offer shares to public subscription tranche & clawback, allowing:
   (a) allocate 5% of shares, subject to clawback of up to 20%; or (b) allocate 10% of shares with no clawback

9. **pricing flexibility mechanism** – permit upward pricing flexibility of up to 10% above top of offer price range

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[1] HKEX's consultation paper, https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/December-2024-Optimise-IPO-Price/Consultation-Paper/cp202412.pdf

Key proposals on open market requirements

1. Calculation of public float

The Exchange has proposed that the public float percentage of securities new to listing be calculated, normally, by reference to the total number of securities of that class only (i.e. in the case of a PRC issuer, the numerator would be calculated by reference to its H shares only).

Currently, shares that are in issue but listed on other regulated markets (i.e. A shares listed on a PRC stock exchange) are counted in the numerator for the purpose of this calculation, even though they are not fungible with the shares listed in Hong Kong and so do not contribute towards the formation of an open market. The proposal will ensure that only securities that contribute towards an open market in trading on the Exchange are included in the numerator for the calculation of the public float.

2. Initial public float

The Exchange has proposed to introduce a tiered initial public float threshold to replace the existing threshold:

Tier	Expected market value of relevant class of securities at the time of listing	Minimum percentage of securities to be held in public hands
A	≤ HK$6B	25%
B	> HK$6B to HK$30B	Higher of: (i) HK$1.5B in public hands; and (ii) 15%
C	> HK$30B to HK$70B	Higher of: (i) HK$4.5B in public hands; and (ii) 10%
D	> HK$70B	Higher of: (i) HK$7.0B in public hands; and (ii) 5%

Tiers A and B are the same as the current 25% percentage threshold and 15% public float waiver threshold, while the introduction of tiers C and D aim to help ensure that the Exchange remains an attractive listing venue for large cap and mega cap issuers, with percentage thresholds of 10% and 5% better aligning with public float requirement of other international stock exchanges.

The Exchange notes that current initial public float threshold is relatively high compared to those of other international stock exchanges. The uncertainty arising from the case-by-case waiver approach may also contribute towards the decision of some applicants to choose an alternative listing venue. The proposal would provide greater certainty to listing applicants, particularly mega cap listing applicants, of the minimum public float that they will be required to meet at listing and reduce the need for new applicants to apply for a waiver.

If the tiered initial public float threshold proposal is supported by the market, the Exchange would also like to seek views on corresponding amendments to the requirements for ongoing public float. Changes to both initial and ongoing public float requirements would be implemented together, as one package, only after both proposals are concluded.

3. Ongoing public float

The Exchange is seeking views on whether issuers should be allowed the flexibility to maintain a lower public float level, after listing, than that required at listing, and whether the existing regulatory approach of suspending trading of issuers with public float below a prescribed level should be maintained.

Currently, after listing, issuers are required to maintain the same public float they had at listing, irrespective of whether their market capitalisation rises or falls over time. The Exchange will suspend trading in an issuer's shares if its public float percentage falls below 15%, which deprives shareholders of their ability to trade even when an open market may still exist in their securities. In addition, a listed issuer may be discouraged from conducting certain corporate transactions (i.e. share repurchase) if doing so would result in a breach of the ongoing public float requirement, even if the transaction may be beneficial to the issuer and its shareholders.

4. Free float

The Exchange has proposed to require all new applicants to ensure that a portion of the class of shares for which listing is sought on the Exchange be held by the public and not subject to any disposal restrictions at the time of listing. This free float in public hands must either:
(a) represent at least 10% of the number of shares in the relevant class for which listing is sought, with an expected market value of at least HK$50 million; or
(b) have an expected market value of at least HK$600 million at the time of listing.

Upon an issuer's listing, some of its shareholders may be subject to share lock-up, such as due to applicable law and regulations, as well as contractual lock-ups. Currently, the Exchange does not impose any requirement for initial listing shares to be free from lock-up. If a substantial portion of shares counted in the public float are held by persons subject to disposal restrictions, they would be unavailable for trading for a period of time after listing, which may negatively affect the establishment of an active trading market following listing. The proposal aims to ensure there will be a sufficient number of shares held by the public that are available for trading upon listing, in order to establish an active trading market following listing.

5. A+H issuers

The Exchange has proposed to lower the existing requirement for PRC issuers (and issuers with other share classes listed overseas) to list at least 15% of the total number of their issued shares on the Exchange, by replacing it with the requirement to have shares for which listing is sought on the Exchange, must at the time of listing, either: (a) represent at least 10% of the total number of issued shares[2] (excluding treasury shares); or (b) have an expected market value of at least HK$3 billion.

The purpose of the minimum threshold requirement is to ensure that a sizeable proportion of securities will be listed on the Exchange, to attract a "critical mass" of investor interest. Stakeholders commented that the 15% threshold is too high for issuers with very large market capitalisation, particularly A+H issuers, and so may inhibit their wish to list in Hong Kong. These issuers may have no immediate need to raise such a large amount of funds and a small offer size may better suit their commercial requirements. The proposals aim to address the issued identified above, while ensuring that the minimum threshold still represents a meaningful amount to attract a "critical mass" of investor interest in such issuers' securities in Hong Kong.

Key proposals on IPO price discovery

6. Cornerstone investment

The Exchange is seeking market views on whether to retain the current six-month lock-up requirement, or to allow a staggered lock-up release such that, at a minimum: (a) all IPO securities placed to cornerstone investors will be subject to a lock-up period of three months following the listing date; and (b) 50% of the IPO securities placed to cornerstone investors will be subject to a lock-up period of three months commencing on the date on which the period as referred to in (a) expires.

Participation in the cornerstone placing tranche signals to potential investors that the corner investors has confidence in the IPO, as they are willing to commit to take up shares at an early stage and are also willing to have their shares locked up for six months. However, large cornerstone placings can lead to price volatility at the expiry of the six-month lock-up period, as the market anticipates that cornerstone investors may look to sell as soon as the lock-up expires (known as the "overhang" of shares). The proposal may potentially alleviate the sharp share price volatility on the release of the lock-up and improve post-listing liquidity, but could also potentially trigger more frequent overhang of shares.

7. Bookbuilding placing tranche

The Exchange has proposed that at least 50% of the total number of shares initially offered in an IPO be allocated to investors in the bookbuilding placing tranche.

As bookbuilding placees indicate the price they are willing to pay and the amount of shares they are willing to subscribe for, to facilitate the determination of the final offer price, they are key "price setters" in an IPO. However, the Exchange currently does not impose any minimum percentage of IPO shares that must be allocated to the bookbuilding placing tranche. This means that it is possible for bookbuilding placing tranche to be relatively small and thus, not contribute effectively to the determination of the final IPO price. The proposal helps ensure that a meaningful portion of IPO shares is always allocated to that tranche, to help optimise the "price setting" function of the bookbuilding placing tranche in an IPO.

8. Public subscription tranche

The Exchange has proposed to replace the existing requirement (minimum initial allocation of 10% of offer shares to the public subscription tranche with a clawback mechanism[3] of up to 50%), with the following options:
(a) a minimum initial allocation of 10% of offer shares to the public subscription tranche with no clawback mechanism; or
(b) a minimum initial allocation of 5% of offer shares to the public subscription tranche with a clawback mechanism of up to 20% (see below)

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[2] In the case of a new applicant that is a PRC issuer with other listed shares, such as an A+H issuers, the shares for which listing is sought on the Exchange should represent at least 10% of the total number of shares in the class to which the H share belong.

[3] Where there is significant excess demand under the public subscription tranche, an issuer is required to switch the allocation of IPO shares from the bookbuilding placing tranche to the public subscription tranche.

	Initial allocation	Demand for shares in the public subscription tranche in number of times (x) the initial allocation	
		≥10x to <50x	≥50x
Minimum % of offer shares allocated to public subscription tranche	5%	10%	20%

The minimum allocation to the public subscription tranche requirement, together with the clawback mechanism, reduces the proportion of shares that can be allocated to investors in the bookbuilding placing tranche who, as mentioned above, are key "price setters" of the final offer price. In these circumstances, the issuer may be able to set a high final IPO price that would not be acceptable to bookbuilding places, resulting in greater risk of poor share price performance after listing. In addition, the clawback mechanism leads to less certainty as to whether bookbuilding investors will receive the allocation they have indicated they are willing to purchase, which may deter them from participating in Hong Kong IPOs.

9. **Pricing flexibility mechanism**

The Exchange has proposed to expand the existing pricing flexibility mechanism by allowing listing applicants to adjust the final offer price upward, after prospectus publication, by a maximum of 10% above the indicative offer price or the top of the offer price range.

Currently, a new applicant is permitted to set the final offer price at no more than 10% below the indicative offer price (or bottom end of the offer price range), before listing, without delaying its listing or publishing a supplemental prospectus. However, to price an IPO above the indicative offer price (or offer price range), a new applicant is still required to publish a supplemental prospectus and delay its listing timetable. The proposal aims to strike an appropriate balance between providing flexibility to listing applicants to respond to unexpected market conditions or demand, while providing meaningful guidance to investors in determining whether to participate in an IPO.

The Exchange has also proposed an opt-in arrangement that would allow public offer subscribers to indicate whether they want to subscribe for shares if the final offer price is adjusted, allowing investors flexibility to decide whether or not to participate in the pricing flexibility mechanism according to their risk appetite.

Consultation Period

The Exchange invites public comments on their proposals until Wednesday, 19 March 2025. After reviewing all responses and comments, the Exchange will develop consultation conclusions and final amendments to the Listing Rules.

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