

Client Alert

Corporate Finance

12 November 2021

Getting prepared for Hong Kong's new conduct requirements for bookbuilding and placing activities which will take effect in August 2022

On 29 October 2021, the Securities and Futures Commission (**SFC**) released the [Consultation Conclusions](#) on (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (ii) the "Sponsor Coupling" Proposal.

The proposals received broad support, and will be adopted with a few modifications, including, among other things:

- the sponsor coupling proposal is modified such that it will apply to Main Board IPOs only; and
- "overall coordinators" will not be required to provide advice to the issuer on syndicate membership or fee arrangements, but should provide guidance to the issuer on the market's fee split practice.

The new conduct requirements for bookbuilding and placing activities will be set out in a new paragraph 21 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) while the sponsor coupling requirement will be reflected in the amended paragraph 17 of the Code of Conduct. There will also be consequential changes to the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks.

The new requirements will become effective on **5 August 2022**.

The salient points of the new requirements are summarised below.

Scope of coverage

The new conduct requirements set out in the new paragraph 21 of the Code of Conduct (**New Conduct Requirements**) will apply to capital market intermediaries engaged in the following activities (**CMIs**):

- bookbuilding activities (i.e. collating investors' orders (including indications of interest) in an offering in order to facilitate: (i) the price determination and the allocation of shares or debt securities to investors; or (ii) the process of assessing demand and making allocations);
- placing activities (i.e. marketing or distributing shares or debt securities to investors pursuant to those bookbuilding activities); or
- advising, guiding and assisting the issuer in such bookbuilding and placing activities,

in the following types of offerings:

- share offering (i.e. an offering of shares listed or to be listed on The Stock Exchange of Hong Kong Limited (**SEHK**)); or
- debt offering (i.e. an offering of debt securities listed or unlisted, and offered in Hong Kong or otherwise).

For the avoidance of doubt, the New Conduct Requirements do not cover offerings which do not involve bookbuilding activities, e.g.:

- bilateral agreements or arrangements between the issuer and the investors (i.e. “club deals”);
- transactions where only one or several investors are involved and the terms of the offering are negotiated and agreed directly between the issuer and the investors (i.e. “private placements”); and
- transactions where shares or debt securities are allocated to investors on a pre-determined basis at a pre-determined price.

Syndicate CMI’s which conduct activities such as the overall management of an offering, coordination of bookbuilding or placing activities conducted by other CMI’s, exercising control over bookbuilding activities and making allocation recommendations to the issuer are defined as “overall coordinators” (OCs) under the New Conduct Requirements, and they will be subject to additional conduct requirements.

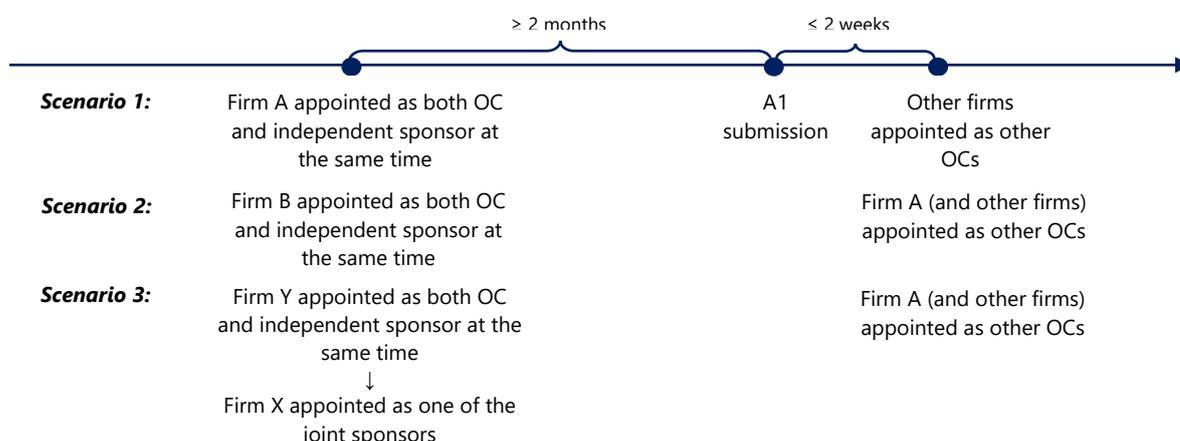
Formal appointment of CMI’s and OCs

Before conducting any bookbuilding or placing activities, a CMI / OC should ensure that it has been formally appointed by the issuer (or another CMI in the case of a non-syndicate CMI) under a **written agreement** which clearly specifies its roles and responsibilities, the fee arrangements (including the fixed fees as a percentage of the total fees to be paid to all syndicate CMI’s) and the fee payment schedule.

Early appointment of OCs and Main Board IPO Sponsor coupling

- In the case of a **Main Board IPO**, before accepting an appointment:

<p>an OC (i.e. Firm A in all the three scenarios below) should either:</p> <ul style="list-style-type: none"> - ensure that it (or one of its group companies) is also appointed as a sponsor, which is independent of the issuer, and that both appointments are made <u>at the same time and at least two months before the submission of the listing application</u> (see Scenario 1); or - obtain a written confirmation from the issuer that at least one sponsor, which is independent of the issuer, or a group company of that sponsor, has been appointed as an OC, in which case its appointment as an OC should be made <u>no later than two weeks after the submission of the listing application</u> (see Scenarios 2 & 3). 	<p>a sponsor (i.e. Firm A in Scenario 1 and Firm X in Scenario 3 below) should either:</p> <ul style="list-style-type: none"> - be independent of the listing applicant and ensure that it or one of the companies within its group of companies is appointed <u>at the same time</u> as an OC in connection with that listing application (see Scenario 1); or - obtain written confirmation from the listing applicant that at least one sponsor, which is independent of the listing applicant, or one of the companies within the group of companies of that sponsor, has been appointed as an OC in connection with that listing application (see Scenario 3).
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- In the case of a **GEM IPO**, an OC should ensure that it is appointed as an OC no later than two weeks after the submission of the listing application.

Advice to the issuer

- An OC should advise the issuer on the pricing with reference to, for instance, the results of the bookbuilding activities, the characteristics of the issuer, prevailing market conditions and sentiment and the requirements of the relevant authorities.
- An OC which participates in a **share offering** should:
 - provide guidance to the issuer on the market's practice in relation to the ratio of fixed and discretionary fees to be paid to syndicate CMIs (N.B.: The current fee split ratio is approximately 75% fixed and 25% discretionary. The fee split ratio will be reported to the SFC no later than four clear business days before the Listing Committee hearing. The SFC may make enquiries if the ratio significantly deviates from the market practice); and
 - advise and guide the issuer and its directors as to their responsibilities under the Rules Governing the Listing of Securities on SEHK and other regulatory requirements or guidance issued by SEHK from time to time (**SEHK Requirements**) which apply to placing activities and take reasonable steps to ensure that they understand and meet these responsibilities.

Assessment of the issuer and the offering

<ul style="list-style-type: none"> • A CMI should conduct an adequate assessment of the issuer before engaging in an offering, including: <ul style="list-style-type: none"> - taking reasonable steps to obtain an accurate understanding of the history and background, business and performance, financial condition and prospects, operations and structure of the issuer; and - establishing a formal governance process to review and assess the offering, including any actual or potential conflicts of interest between the CMI and the issuer as well as the associated risks. 	<ul style="list-style-type: none"> • An OC should: <ul style="list-style-type: none"> - inform other syndicate CMIs of the issuer's marketing and investor targeting strategy; and - disseminate material information relating to the offering in a timely manner to all syndicated CMIs and ensure such information is complete, accurate and has a proper basis.
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Assessment of investors

<ul style="list-style-type: none"> • A CMI should take reasonable steps to assess whether its investor clients, based on their profiles, fall within the types of investors targeted in a marketing and investor targeting strategy (targeted investors). • In the case of a share offering, a CMI should take all reasonable steps to identify investor clients to whom the allocation of shares will be subject to restrictions or require prior consent from SEHK under the SEHK Requirements, and inform the OC before placing an order on behalf of such clients. • In the case of a debt offering, a CMI should take all reasonable steps to identify whether its investor clients may have any associations with the issuer, the CMI or a company in the same group of companies as the CMI and provide sufficient information to an OC to enable it to assess whether orders placed by these investor clients may negatively impact the price discovery process. 	<ul style="list-style-type: none"> • In the case of an IPO, an OC should: <ul style="list-style-type: none"> - advise the issuer to provide to all syndicate CMIs a list of its directors, existing shareholders, their close associates and nominees engaged by any of the above for the subscription or purchase of shares offered in the IPO; and - take all reasonable steps to identify investors on that list and ensure that they will only be allocated shares in accordance with the applicable SEHK Requirements. • In the case of a debt offering, an OC should: <ul style="list-style-type: none"> - advise the issuer to provide sufficient information to all syndicate CMIs to enable them to reasonably identify whether investor clients have any associations with the issuer; and
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	<ul style="list-style-type: none"> - take all reasonable steps to identify whether investor clients have any associations with the issuer, CMI or their group companies.
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No rebate or preferential treatment

<ul style="list-style-type: none"> • A CMI should <u>not</u>: <ul style="list-style-type: none"> - offer any rebates to an investor client or pass on any rebates provided by the issuer to an investor client; - in the case of an IPO, enable any of its investor clients to pay, for each of the shares allocated, less than the total consideration as disclosed in the listing documents; and - in the case of a debt offering, enter into any arrangements which may result in investor clients paying different prices for the debt securities allocated. • A CMI should disclose to the issuer, OCs, all of its targeted investors and the non-syndicate CMIs it appoints, any rebates offered to CMIs and any other preferential treatment of any CMIs or targeted investors (such as guaranteed allocations): <ul style="list-style-type: none"> - in the case of a share offering, upon becoming aware of any such rebates or preferential treatment; and - in the case of a debt offering, no later than the dissemination of the deal “launch message” to targeted investors. 	<ul style="list-style-type: none"> • An OC should advise the issuer against providing any arrangements whereby: <ul style="list-style-type: none"> - in the case of an IPO, the investor clients would pay, for each of the shares allocated, less than the total consideration as specified in the listing documents; and - in the case of a debt offering, the investor clients would pay different prices for the debt securities allocated. • An OC should advise the issuer of the disclosure of any rebates and preferential treatment.
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Order book management and allocation

<ul style="list-style-type: none"> • A CMI should: <ul style="list-style-type: none"> - take reasonable steps to ensure that all orders placed in an order book represent bona fide demand of its investor clients, itself and its group companies; - make enquiries with its investor clients about orders which appear unusual (e.g. an order which is not commensurate with the investor client’s financial profile) before placing the order; - ensure transparency in the bookbuilding process and disclose the identities of all investor clients in an order book, except for orders placed on an omnibus basis. For orders placed on an omnibus basis, a CMI should provide information about the underlying investor clients (i.e. the investor client’s name and unique identification number) to the OC and the issuer when placing the orders; - always give priority to satisfying investor clients’ orders over its own proprietary orders and those of its group companies (including orders placed on 	<ul style="list-style-type: none"> • An OC should: <ul style="list-style-type: none"> - take reasonable steps to properly manage an order book and ensure the transparency of the order book; - make enquiries with CMIs which have placed orders on behalf of their investor clients, themselves or their group companies which appear unusual or irregular (e.g. orders which appear to be related to the issuer); - ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis; - segregate and clearly identify in the order book and book messages any proprietary orders of CMIs and their group companies; - properly consolidate orders in the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies or errors;
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<p>behalf of funds and portfolios in which a CMI or its group company has a substantial interest);</p> <ul style="list-style-type: none"> - only be the price taker in relation to its proprietary orders and those of its group companies and ensure that these orders would not negatively impact the price discovery process; - segregate and clearly identify its own proprietary orders and those of its group companies in the order book and book messages; - in the case of a debt offering, disclose to the issuer how any risk management transaction it intends to carry out for itself, the issuer or its investor clients will not affect the pricing of the debt securities; and - establish and implement an allocation policy to ensure a fair allocation of securities to its investor clients. 	<ul style="list-style-type: none"> - ensure that the proprietary orders of CMIs or their group companies and, for debt offering, the orders placed by investor clients which have associations with the issuer, CMIs or their group companies, will not negatively impact the price discovery process; and - develop and maintain an allocation policy which sets out the criteria for making recommendations to the issuer, taking into account the issuer's objectives or preferences, prevailing market conditions, types and characteristics of targeted investors, spread of investors and the overall subscription rate for the offer.
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Disclosure of IPO fee arrangements to the SFC

An OC should provide the following information to the SFC by no later than four clear business days prior to the Listing Committee hearing:

- the name of each OC participating in the offering;
- the allocation of the fixed portion of the fees paid by the issuer to each OC;
- the total fees (as a percentage of the gross amount of funds raised) to be paid to all syndicate CMIs; and
- the ratio between the fixed and discretionary portions of the total fees to be paid to all syndicate CMIs (in percentage terms).

Record keeping

<ul style="list-style-type: none"> • A CMI should maintain books and records which are sufficient to demonstrate its compliance with all applicable requirements (including audit trails from the receipt of orders, the placing of orders in the order book through to final allocation and records of allocation decisions). 	<ul style="list-style-type: none"> • An OC should document, among other things, all changes in the orders in the order book throughout the bookbuilding process and all key discussions with, and key advice or recommendations provided to, the issuer.
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Getting prepared

In view of the new requirements becoming effective on **5 August 2022**, capital market intermediaries should start reviewing their existing internal control systems, policies and procedures as well as standard form documentation (including, for example, the engagement letters) and making necessary changes or enhancements in order to ensure compliance with the new requirements.

Intermediaries should also be mindful that compliance with the new requirements will inevitably involve extra time, costs and resources, which should be carefully factored in when planning for upcoming deals.

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