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IPO cornerstone investments and placing allocation  
  
5% shareholders and their close associates: now possible  
Connected clients: revisited   
Close associates of PRC governmental bodies: requirements relaxed

Today, the Hong Kong Stock Exchange relaxed the restrictions on connected clients of an IPO placing broker/distributor and existing shareholders making cornerstone investments or participating in the placing tranche. The conditions applicable to allocations to certain connected clients have been aligned, and existing shareholders now have greater flexibility to participate in IPOs.

**The major points to note:**

* *Participation as a cornerstone investor*: The Exchange will no longer regard the guaranteed allocation available to cornerstone investors as a barrier to connected clients or existing shareholders applying for a Rule 10.04 or Placing Guideline consent. There is now a roadmap for connected clients who hold securities on behalf of independent investors (i.e. discretionary and non-discretionary funds) (a “**Qualified Connected Client**”) and shareholders holding less than 5% of an IPO applicant’s voting rights before listing or its close associates (a “**5% shareholder investor**”) to participate in the cornerstone tranche.
* *A 5% shareholder investor may now participate in the IPO*: Subject to confirmations regarding no preferential treatment (see below), the Exchange will generally permit a 5% shareholder investor to invest in the IPO (either as a cornerstone investor or in the placing tranche) if (i) it is not a core connected person of the IPO applicant or its close associate, and (ii) it does not have any special rights, including any right to appoint directors of the IPO applicant.
* *Confirmations of no preferential treatment are still required, but have been clarified and aligned*: The Exchange has provided clarity as to the confirmations required from parties to the IPO to demonstrate that no preferential treatment has been given to Qualified Connected Clients and 5% shareholder investors in the allocation of securities.
* *Relaxation for close associates of PRC governmental bodies which are existing shareholders*: The Exchange will now generally permit close associates of PRC governmental bodies which are existing shareholders to participate as cornerstone investors or in the placing tranche without requiring confirmations as to no preferential treatment.

**Implications**

While the requirement to seek consent from the Exchange pursuant to Rule 10.04 and the Placing Guidelines will remain under the new guidance, so long as a Qualified Connected Client or a 5% shareholder investor meets the relevant conditions and requirements, we anticipate the process for seeking the Exchange’s consent will become more procedural, offering market participants greater certainty. It is worth noting that the new guidance does not address the treatment of sovereign wealth funds which are connected clients. We understand the Exchange will continue to consider consent applications by such connected clients on a case by case basis.

**Background**

The Placing Guidelines (Appendix 6 to the Hong Kong Listing Rules) require consent from the Exchange to allow distributors to allocate IPO shares in the placing tranche (including participation as cornerstone investors) to connected clients, directors and existing shareholders. In addition, Rules 10.03 and 10.04 restrict an IPO applicant from offering shares to its directors and existing shareholders in a preferential manner. The restrictions are put in place to address regulatory concerns that connected clients or existing shareholders and their associates may exert substantial influence over distributors and/or IPO applicants to obtain preferential treatment in allocations.

The Exchange acknowledges that not all connected clients and existing shareholders can exert substantial influence over IPO allocation decisions, and has in the past issued guidance to explain the conditions that a Qualified Connected Client or existing shareholder must satisfy in order for allocations to them to be permitted. The Exchange’s guiding principle is that its consent may only be granted if it is satisfied that no actual or perceived preferential treatment in the allocation process will be given to an investor.

The Exchange has reviewed its current practice, the policy rationale of the restrictions, and published a new guidance letter (GL85-16), aligning, and in some cases relaxing, its current practice (repealing GL75-14 and LD90-1). The Exchange has not removed the requirement to seek its consent pursuant to Rule 10.04 and the Placing Guidelines, but the consent seeking process is expected to become procedural.

**Participation as a cornerstone investor**

In the past, connected clients and existing shareholders had no way of getting the Exchange’s consent to participate in cornerstone investments due to the assumption of preferential treatment arising from the guaranteed allocation in the cornerstone participation.

In the new guidance letter, the Exchange explained that it will no longer regard the guaranteed allocation available to cornerstone investors as a barrier to connected clients or existing shareholders applying for a Rule 10.04 or Placing Guideline consent. The only requirement of the Exchange is that such investment be made on the same terms and conditions as other independent cornerstone investors – i.e., by complying with the conditions set out in GL51-13.

**5% shareholder investor: now possible**

In the past, the Exchange granted consent to existing shareholders participating in the placing tranche of an IPO only in very limited circumstances (see LD90-1, which has been superseded by the new guidance). In the new guidance, the Exchange made clear that an existing shareholder holding less than 5% of the voting rights of the IPO applicant prior to listing, and its close associates, can demonstrate that it will not receive any preferential treatment, and thus may participate either as a cornerstone investor or in the placing tranche with its consent, if the following conditions are satisfied:

1. the 5% shareholder is not a core connected person of the IPO applicant or its close associate;
2. the 5% shareholder does not have any special rights, including the power to appoint directors of the IPO applicant;
3. the public float requirement can be met;
4. the sponsor confirms that, to the best of its knowledge and belief, the 5% shareholder investor has not received preferential treatment in the IPO allocation (other than, in the case of a cornerstone investment, the preferential treatment of a guaranteed allocation at the IPO price) (the “**Sponsor Confirmation**”);
5. the IPO applicant confirms that no preferential treatment in the IPO application has been given to the 5% shareholder investor and (in the case of a cornerstone investment) the material terms of the cornerstone investment agreement of the 5% shareholder investor are not more favourable compared with other cornerstone investors (the “**IPO Applicant Confirmation**”); and
6. in the case of a participation in the placing tranche, the bookrunners confirm that no preferential treatment in the IPO application has been given to the 5% shareholder investor (the “**Bookrunners Confirmations**”).

These conditions are also applicable to holders of convertible instruments issued by the IPO applicant. The new guidance contains prescribed wording for confirmations to be given by various parties, some of which allow qualifications to be included and the relevant party giving the confirmations to rely on confirmations given by others.

The Exchange believes there is a greater risk of actual or perceived preferential treatment in favour of shareholders with a larger percentage shareholding, as they will have greater influence over the decision of the IPO applicant, in particular if the shareholder is otherwise connected or has the right to appoint directors. The general benchmark is set at a 5% interest in voting rights prior to listing, which aligns with the minimum shareholding for triggering substantial shareholder disclosures under Part XV of the Securities and Futures Ordinance. Nevertheless, we believe the door is not completely shut for shareholders holding more than 5% voting rights if the IPO applicant already has an overseas listing and if unique circumstances apply to it which clearly demonstrate a lack of influence of the shareholder on the IPO applicant.

**Connected client requirements: revisited**

In the past, the Exchange accepted that Qualified Connected Clients may be able to demonstrate that they do not receive any preferential treatment in the allocation process if certain confirmations are given and conditions are satisfied. These confirmations and conditions depended on whether the Qualified Connected Clients held securities on a non-discretionary or discretionary basis.

In the new guidance letter, the Exchange has maintained its requirement for confirmations, but the scope has been aligned and consolidated between both groups of Qualified Connected Clients. In particular, confirmations that no preferential treatment has been given will be required from each of the sponsor, the IPO applicant, the bookrunners, the connected distributor and the Qualified Connected Client itself. The only distinction between the two groups is that the Exchange highlights its heightened concerns over the risk of preferential treatment being given to *discretionary* Qualified Connected Clients by requiring that their connected distributors be excluded from the allocation process in so far as it relates to their *discretionary* Qualified Connected Clients. This is less draconian than previous experiences of the Exchange prohibiting connected distributors from introducing their connected clients as potential investors, but is nevertheless onerous from a practical perspective.

See the table at the end of this bulletin for a summary of the confirmations required.

**Close associates of PRC governmental bodies: requirements relaxed**

The Exchange has indicated a different approach for close associates of existing shareholders which are PRC governmental bodies. In particular, the Exchange will grant consent to such close associates to participate as cornerstone investors or in the placing tranche without requiring confirmations as to preferential treatment, provided that they: (a) are genuine investors who operate independently of the PRC governmental bodies; and (b) have no access to material non-public information regarding an IPO and no influence over the allocation process of the IPO.

We believe this new approach should ease the burden of close associates of Central Huijin to the extent they participate as cornerstone investors or in the placing tranche of IPOs.

**A summary of the conditions**

| Conditions | Parties to provide the relevant confirmations with | | |
| --- | --- | --- | --- |
| **Non-discretionary Basis Conditions** | **Discretionary Basis Conditions** | **Existing Shareholders Conditions** |
| 1. Securities are held on behalf of independent third parties | ✓ | ✓ |  |
| 2. Confirmation that cornerstone investment agreement does not contain any material terms which are more favourable to the connected client/existing shareholder or its close associates from: | | | |
| - applicant | ✓ | ✓ | ✓ |
| 3. No preferential treatment confirmations from: | | | |
| - applicant | ✓ | ✓ | ✓ |
| - connected broker/distributor | ✓ | ✓ |  |
| - bookrunners | ✓ | ✓ | ✓ |
| - connected client | ✓ | ✓ |  |
| - sponsor | ✓ | ✓ | ✓ |
| 4. Confirmation that connected broker/distributor did not participate in decision-making /discussions regarding allocations to the connected client from: | | | |
| - applicant |  | ✓ |  |
| - connected broker/distributor |  | ✓ |  |
| - bookrunners |  | ✓ |  |
| 5. Existing shareholder | | | |
| - is interested in less than 5% of an applicant’s voting rights |  |  | ✓ |
| - is not a core connected person or its close associate |  |  | ✓ |
| - does not have the power to appoint directors or any other special rights |  |  | ✓ |
| 6. Allocation to the existing shareholder or its close associates will not affect the applicant’s ability to satisfy the public float requirement |  |  | ✓ |

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