



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

Joint Statement



20 January 2017

## Joint statement regarding the price volatility of GEM stocks

### Background

1. The Securities and Futures Commission (**SFC**) and The Stock Exchange of Hong Kong Limited (**Exchange**) have been monitoring GEM stocks that exhibited unusually high price volatility post-listing.
2. The average first-day price gain<sup>1</sup> was 743% for all GEM stocks listed in 2015 and 454% for those listed in the first half of 2016. The comparable figures for Main Board stocks were 5% and 15%, respectively.
3. Of the top 10 first-day gainers on GEM in 2015, half saw their share prices plunge by over 90% from their peak within a month. On average, the trading prices of GEM stocks listed in 2015 fell by 47% within a month of their peak.
4. The sharp first-day price movements of recently listed GEM stocks were accompanied by thin trading. On average, the first-day turnover ratio<sup>2</sup> was 13% for all GEM stocks listed in 2015 and 15% for GEM stocks listed in the first half of 2016. The comparable figures for Main Board stocks were 42% and 61%, respectively.
5. Almost all GEM IPOs were conducted by way of placing only<sup>3</sup>. Many listed GEM stocks have highly concentrated shareholdings and a small shareholder base. On average, in the GEM IPOs listed during 2015 and the first half of 2016, the top 25 placees took up 96% of the shares offered for placing and the average number of placees for the entire issue was 135.

### Regulatory concerns

6. Based on a recent review of GEM IPO placings, the SFC has observed that, in a number of placings, (a) the allocation of a substantial majority of the offered shares were attributable to a small proportion of the placing agents involved in the transaction, who placed those shares to a small number of placees (**top placees**), while (b) the remainder of the offered shares were placed in small quantities (usually one or two board lots) to a large number of placees. While the number of placees exceeded 100, the final allocation was substantially similar in effect to a placing of the offered shares only to the top placees and resulted in a high concentration of shareholdings among the top placees. In addition, the SFC has observed that a handful of investors repeatedly appeared as the top placees in otherwise unconnected GEM IPOs.

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<sup>1</sup> First day price gain = (difference between first day closing price and IPO price) / IPO price

<sup>2</sup> First day turnover ratio = shares traded on the first day / placing shares

<sup>3</sup> Out of a total of 49 GEM IPOs in 2015 and in the first half of 2016, 48 GEM IPOs were conducted by way of placing only.

7. The SFC and the Exchange consider that these market developments and practices may undermine GEM Rule 11.23 (which provides that there must be an open market in the securities for which listing is sought<sup>4</sup>) and may not enable an orderly, informed and efficient market for such securities to develop.
8. The principal function of the Exchange is to provide a fair, orderly and efficient market for the trading of securities<sup>5</sup> and the Exchange has a statutory duty to ensure an orderly, informed and fair market in securities that are traded on its market or through its facilities. It is a statutory function of the SFC to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures market<sup>6</sup>.
9. A new applicant seeking to list on GEM (**new applicant**) should ensure compliance with all relevant GEM Listing Rules including ensuring that the conditions exist for an open market as well as orderly, informed and fair trading to develop in the relevant securities at the time of listing. In this regard, the new applicant should assess, inter alia, the likely interest of different prospective investors in the offered securities and their profiles and determine an appropriate allocation basis in order to satisfy GEM Rule 11.23 and other relevant GEM Listing Rules. The new applicant should also ensure that any preferential treatment afforded to any placee is adequately disclosed in the listing document.

#### **Adequate spread of holders**

10. GEM Rule 11.23 states that there must be an open market in the securities for which listing is sought. GEM Rule 11.23(2) further explains that, among other things, for all equity securities except for warrants<sup>7</sup>, there must, as at the time of listing, be an adequate spread of holders of such securities. The number will depend on the size and nature of the issue but, as a guideline, the equity securities in the hands of the public should, as at the time of listing, be held among *at least* 100 persons (including those whose equity securities are held through CCASS)<sup>8</sup>.
11. GEM Rule 11.23(2) is clear that the minimum requirement of 100 public holders merely serves as a guideline. Meeting the minimum requirement alone does not mean that the GEM Rule 11.23 requirement for an open market has been satisfied. The SFC and the Exchange are of the view that where the securities in the hands of the public are overly concentrated, the conditions for an open market may not exist even if such securities are held by 100 holders, being the minimum number of placees under the GEM Rule 11.23.

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<sup>4</sup> GEM Rule 11.23 and 11.23(2)

<sup>5</sup> GEM Rule 2.01

<sup>6</sup> Section 5(1)(a) of the Securities and Futures Ordinance

<sup>7</sup> GEM Rule 11.23(2) and (3)

<sup>8</sup> GEM Rule 11.23(2)(b)

12. Nominees, who take up or hold securities in a placing on behalf of other persons who are the ultimate beneficial owners, cannot be regarded as distinct placees<sup>9</sup>. This should be taken into account when assessing the adequacy of spread of holders of these equity issues.

### **Shares “in public hands”**

13. It is a requirement that a minimum prescribed percentage of the offered securities be in public hands. The GEM Listing Rules set out provisions regarding when a holder would not be considered to be a member of “the public” or when securities would not be considered as being “in public hands”<sup>10</sup>.
14. Consistent with the intention of the GEM Listing Rules, a placee who receives any direct or indirect benefit, whether financial or otherwise, from any person referred to in note 2 to GEM Rule 11.23(11) in exchange for taking up the placing securities would not be regarded as a member of the “public” and any securities held by such person would not be “in public hands” for the purposes of GEM Rule 11.23.
15. The SFC and / or the Exchange, where appropriate, will take appropriate actions with respect to any proposal, arrangement or agreement whereby one or more persons (a) takes up securities in a placing on behalf of, (b) holds securities on behalf of, or (c) otherwise acts in accordance with the instructions of, any person referred to in note 2 to GEM Rule 11.23(11), with a view to avoiding the application of any GEM Listing Rule.

### **Preferential treatment**

16. With regard to any securities proposed to be placed by a new applicant, no preferential terms or treatment as to price or otherwise may be afforded to any placee unless adequate disclosure of such terms or treatment is made in the listing document. The listing document must at least disclose the information required in GEM Rule 13.02(1)<sup>11</sup>. The Exchange reserves the right to reject any such proposed arrangements<sup>12</sup>. For the avoidance of doubt, this provision applies whether or not the preferential terms are offered by new applicants or other persons (e.g. underwriters or placing agents) or whether or not placees are persons referred to in notes 1 and 2 to GEM Rule 10.12.

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<sup>9</sup> GEM Rule 10.12(1)

<sup>10</sup> Notes 2 and 3 to GEM Rule 11.23(11)

Note 2 to GEM Rule 11.23(11) provides that, “The Exchange will not regard at any time, (a) in relation to an issuer other than a PRC issuer, and other than any subsidiaries of a PRC issuer, a director, chief executive or substantial shareholder of such issuer or any of its subsidiaries or a close associate of any of them; or (b) in relation to a PRC issuer, a promoter, director, supervisor, chief executive or substantial shareholder of the PRC issuer or any of its subsidiaries or a close associate of any of them as a member of “the public” or shares held by any such person as being “in public hands”.”

Note 3 provides that, “The Exchange will also not recognise as a member of “the public”:— (a) any person whose acquisition of securities has been financed directly or indirectly by a person referred to in note 2 above; or (b) any person who is accustomed to taking instructions from a person referred to in note 2 above in relation to the acquisition, disposal, voting or other disposition of securities of the issuer registered in his name or otherwise held by him.”

<sup>11</sup> Paragraph 11(a)(v) of the SFC Guideline

<sup>12</sup> GEM Rule 13.02(1) and 10.12(3)

17. Preferential terms or treatment may include a guaranteed allocation, an unusually large allocation, an agreement to allocate securities in another IPO, a waiver or rebate of brokerage commission, a put option or offer to repurchase the offered securities after the listing or any other arrangement entered into on a non-arm's length basis in exchange for placees taking up the offered securities.

**Role of new applicants, sponsors and underwriters / placing agents (including all sub-underwriters and sub-placing agents)**

18. A new applicant's directors are responsible for ensuring the applicant's full compliance with the GEM Listing Rules<sup>13</sup>; and the new applicant must meet all basic listing conditions as a pre-requisite to the listing of equity securities<sup>14</sup>. The new applicant and its directors must also assist its sponsor to perform its role, including due diligence work<sup>15</sup>. When ensuring that there is an open market in the securities for which listing is sought:
- (a) due care should be taken by the new applicant to decide, in consultation with the sponsor, among other things<sup>16</sup>:
    - (i) the method of listing, in particular, whether the new applicant should adopt an offer for subscription by or sale to the public in addition to a placing tranche;
    - (ii) the target investor type and placee mix (for example, the new applicant may indicate its preference for a percentage of shares to be allocated to long term investors rather than short term investors or institutional investors rather than retail investors);
    - (iii) the overall strategy and allocation basis with a view to achieving an open market and an adequate spread of shareholders and to ensure the percentage of shares in public hands meets the relevant requirements under the GEM Listing Rules. This will generally include selecting an appropriate number of underwriters or placing agents taking into account their client base, competence, resources and track record, as well as their allocation strategy;
    - (iv) any preferential treatment (financial or otherwise) afforded to placees and the relevant disclosure in the listing document; and
  - (b) the new applicant is expected to seek assistance from the underwriters and placing agents to adopt an appropriate strategy and allocation basis with a view to achieving an open market and avoiding any undue concentration in the holdings of its shares;

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<sup>13</sup> GEM Rule 5.03

<sup>14</sup> GEM rule 11.01

<sup>15</sup> GEM Rule 6A.05

<sup>16</sup> Paragraph 11 of SFC Guideline

- (c) the prospectus should list all the underwriters and placing agents appointed and their contact details to provide additional information to investors about available distribution channels.

The new applicant should retain proper documentation as to the matters described in (a) above.

- 19. Sponsors, underwriters and placing agents all play an important role in the listing and placing of GEM IPO securities and should act in the best interests of their clients (including the new applicant) and to assure the overall integrity of the market<sup>17</sup>. The SFC today issued a guideline regarding the standard of conduct that is expected of sponsors, underwriters and placing agents, as licensed or registered persons under the Securities and Futures Ordinance, involved in the listing and placing of GEM IPO securities (<http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guideline-to-sponsors,-underwriters-and-placing-agents-involved-in-the-listing-and-placing-of-gem/guideline-to-sponsors,-underwriters-and-placing-agents-involved-in-the-listing-and-placing-of-gem.pdf>).
- 20. Proper records must be kept by each of the sponsors, underwriters and placing agents documenting their respective involvement in the placing process, including, where applicable, a record of (a) all notifications to clients, (b) all orders received, (c) the rationale for allocation of the securities as well as the reasons for rejection of orders, and (d) the list of placees submitted to the Exchange<sup>18</sup>.

### Potential consequences

- 21. Pursuant to GEM rule 10.12(5), a list of placees must be submitted to the Exchange before dealing in the securities commences. To avoid delay in approving the allotment results announcement, new applicants and their sponsors are encouraged to inform the Exchange in advance of any intended placing of securities to the parties referred to in Notes 1 and 2 to GEM Rule 10.12(4). The SFC or the Exchange may reject any allocations to such parties on the ground that the requirements of GEM Rule 11.23(2)(b) are not met. Where there are concerns that the placing securities may be concentrated in too few hands, or a large number of placees may each hold too few securities or the conditions for an open market may not otherwise exist, the SFC or the Exchange may make enquires. Please refer to paragraph 13(c) of the SFC Guideline for non-exhaustive list of circumstances that may lead to enquiries. In such circumstances the new applicant, sponsors, underwriters and placing agents should be in a position to provide all relevant information in relation to the placing process and all placees in order to avoid any unnecessary delay in the listing timetable.
- 22. The SFC or the Exchange, where appropriate, will take action against those new applicants, sponsors and underwriters or placing agents who fail to have appropriate policies and procedures to ensure that any GEM IPO placing is conducted in a fair and orderly manner.

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<sup>17</sup> Paragraph 10 of SFC Guideline

<sup>18</sup> Paragraphs 13(f) of SFC Guideline

### **Cautionary statement**

23. The public is reminded that GEM is a market designed to accommodate companies that involve a higher investment risk than other companies listed on the Exchange. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors<sup>19</sup>.
24. Given the nature of companies listed on GEM, securities traded on GEM are more susceptible to high market volatility than securities traded on the Main Board. There is no assurance that there will be a liquid market in the securities traded on GEM<sup>20</sup>. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration.

Securities and Futures Commission  
The Stock Exchange of Hong Kong Limited

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<sup>19</sup> GEM Rule 2.12

<sup>20</sup> Note 2 to GEM Rule 2.12