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March 21, 2025

Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square,
8 Connaught Place, Central
Hong Kong

Dear Sir/Madam,

RE: HKEX Consultation Paper ("CP") on Proposals to Optimize IPO Price Discovery and Open Market Requirements

On behalf of the Hong Kong Investment Funds Association, I wish to express our appreciation to the HKEX in spearheading the initiatives to optimize the IPO price discovery process and open market requirements. We are generally supportive of the proposals outlined in the CP. The proposed enhancements are long-awaited and can enable the Hong Kong market to be more aligned with international standards/practices. The enhancements are poised to support a more robust price discovery process; and can potentially attract more long-term investors, as well as enhance market liquidity.

Specific comments:

I. Potential Over-the-Counter (OTC) Market in Hong Kong (CP Questions 4.5, 4.6)

Under the current regime, the HKEX will normally require suspension of trading in an issuer's securities where the percentage of its public float falls below 15% (or 10% in the case of an issuer that has been granted a lower percentage of public float at the time of listing).

From investors' perspectives, suspension of trading is a very blunt tool as it deprives them of the ability to trade. Suspension would also bring complexity to fund valuation as the fund manager/trustee has to consider, inter alia, the characteristics of the stock in question, the specific circumstances as well as a raft of issues to determine the fair value such that the outcomes would be fair to all investors.

Currently, there is no alternative trading platform in Hong Kong for delisted securities. We believe it would be very helpful if the HKEX conducts a feasibility study regarding whether Hong Kong should establish an OTC market to address the issues arising from prolonged trading suspensions and delisting. The study can cover, inter alia, the demand/supply, pros and cons; as well as the costs and benefits. A key focus of the study should be on whether retail investors would be allowed. We can take reference from other markets, e.g. the US, but we must be mindful the context and background of other markets are different, e.g. there are class actions in the US, but not in Hong Kong. This subject requires careful deliberations and we would be keen to work with the HKEX to share our perspectives, especially from the investor protection angle and the implications to the market.

II. Regulatory Lock-up on Cornerstone Investments (CP Question 8)

We support the proposal to have a staggered release of the six-month lock-up period into two tranches.

This proposal can provide more flexibility and thereby encourage more investors to partake as cornerstone investors. The staggered approach would help to spread out the potential share price volatility impact upon the expiry of lock-ups and also improve free float within a shorter period of time.

To implement the proposal of opening up 50% after three months of listing and the remaining 50% after six months from listing, we suggest the sell-side to clearly spell out the 2 staggered lock-up dates in the term sheet so as to ensure that the expiry dates are clear to the market.

III. Bookbuilding placing tranche (CP Question 9)

We strongly support the proposal of having at least 50% of the IPO allocated towards investors in the bookbuilding placing tranche. This would ensure that the pricing of an IPO is underpinned by a robust and rigorous bookbuilding mechanism. Having a larger bookbuilding placing tranche would optimise the pricing process given that bookbuilding placees are key price setters in an IPO; and that it would be more fundamental rather than momentum driven.

This proposal should not be considered in isolation: it should be carefully balanced alongside the other pieces of the proposal, e.g. reduce the cap on the public subscription tranche clawback mechanism, such that the cornerstone tranche remains a meaningful component of the deal and potential cornerstone investors would not be disincentivised because of the change in the relative allocation.

IV. Public Subscription Tranche Clawback Mechanism (CP Question 11)

We strongly support the two proposed mechanisms which aim to enhance the price discovery process. They can give IPO companies flexibility to choose the clawback mechanism that best suits their business characteristics, capital needs, and market demand.

According to data from the HKEX, retail investors currently contribute less than 15% of the trading volume in the Hong Kong stock market, down from over half in 1997. As the investor base evolves, we believe it is imperative to modernize the clawback mechanism so that it can move with times and better match the changing investor mix and profile.

We note that some quarters have put institutional and retail investors into two different camps; and highlight that their interests are not aligned. But ultimately who are institutional investors? Institutional investors, such as fund and asset managers, are investing on behalf of the underlying investors – many of them are retail and pensions funds clients. Fund/asset managers have the fiduciary duty to act in the best interests of these clients. Before they invest in IPOs and/or listed stocks, they have to conduct thorough due diligence and research.

As more and more retail investors participate in the stock market through funds (be it through funds, pensions or other vehicles), we believe that the distinction between institutional and retail has become blurred: the key difference is only how one gets market exposure. With the institutionalisation of retail participation and the change in the investor structure of the Hong Kong market, the focus of our discussion should be on how to ensure that the IPOs can be allocated in an optimal manner such that ***investors as a whole*** can extract the greatest value from the investment. As fund/asset managers have the expertise and resources to perform thorough due diligence on the IPO companies, we believe that the proposals can enable the expertise and contributions of fund/asset managers to come into full play.

Based on an IFEC retail survey conducted in 2021 (latest available), most retail investors invested in IPOs for short term gains, with over half of the respondents indicating they tend to hold the allotted shares for less than one week. On the contrary, the investment horizons of funds are typically much longer; and their focus is on the economic viability/sustainability, growth trajectory and earnings power of the company over the long haul.

Having a larger cohort of investors who are ready to invest for the long-haul is very important to foster long-term investment culture and support the healthy development of the Hong Kong stock market. A perennial problem with the Hong Kong stock market is that except for a small universe of stocks, a large chunk of companies' liquidity is very thin. There is a long tail of illiquid companies. Whilst there are different factors that lead to the long tail, if the framework can allow more fundamental-based investors to partake upfront at the IPO stage (which the proposals pertain to); we can probably see a reduction in the risk of mispricing; and an improvement in liquidity both in terms of depth and quality over time.

As the issuer or the lead manager(s) do not have visibility of the profile and investment objectives of investors in the public subscription tranche, there is generally less certainty and transparency in the post-listing treatment of the IPO shares allocated to the public subscription tranche investors. As such, a smaller percentage of the public subscription tranche will be helpful in reducing high price volatility after the IPO listing.

V. Inclusion of Upward Pricing Flexibility (UPF) (CP Question 13)

Generally, fund managers do not support introducing flexibility for upward adjustment of the indicative price or top of price range. The investor engagement and price discovery process that would take place post the A1 filing and prior to the bookbuilding is robust enough to contribute towards the setting of a price range for the bookbuilding that would adequately reflect investors' conviction and risk appetite. Any upward revision based on the bookbuild momentum would likely be opportunistic in nature and is less likely to be fundamentally driven, and allowing for that may potentially have negative impacts on the quality of the overall orderbook and hence IPO allocation.

In an IPO scenario, investors are already dealing with information asymmetry. To offer UPF post bookbuilding places investors in an even more uncertain and disadvantaged position, which could negatively impact deal appetite.

Furthermore, one has to consider the impacts of an upward price revision on cornerstone investors, who are required to make a firm and binding commitment with guaranteed allocation received prior to the start of the bookbuilding. A cornerstone commitment is currently made up to the top end of the price range, and should there be an upward price revision beyond the top end, it would only be fair to give cornerstone investors the option to re-evaluate and revise their cornerstone investment accordingly prior to the pricing date. And some managers even indicate that if UPF were to be implemented, cornerstone investors should be given the flexibility to get a better allocation of shares which would be commensurate with their commitments.

In addition, the timelines involved for any revisions to be made to the cornerstone agreement are very tight, given a T+2 settlement cycle and potential time zone differences involved depending on the fund managers' location, which may indirectly introduce a higher level of risk to the overall process for cornerstone investors.

In a nutshell, UPF would bring more uncertainty to the process; and we do not see a compelling reason for introducing this mechanism.

If you require clarification or further information, please don't hesitate to contact us. We are most happy to meet up to expound on our thoughts.

Yours sincerely,

[redacted]