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Dear Sirs

Consultation Paper on Proposals to Optimise IPO Price Discovery and Open Market Requirements

Introduction

We refer to the Consultation Paper on **Proposals to Optimise IPO Price Discovery and Open Market Requirements** (the "**Consultation Paper**") issued by the Hong Kong Exchange (the "**Exchange**") on 19 December 2024. Unless otherwise defined, terms used in this letter shall have the meaning ascribed to them in the Consultation Paper.

We welcome the opportunity to comment on the Consultation Paper. Set out below are our observations / comments on some of the proposals raised in the Consultation Paper.

1. Calculation of Public Float

<u>In response to Question 1</u>

Under the current Rules, issuers are required to calculate their public float percentage by reference to the total number of shares they have in issue (excluding treasury shares). Shares that are in issue but listed on other regulated market(s), such as A shares listed on a PRC stock exchange, are counted in both the numerator and denominator for the purpose of this calculation.

The Exchange proposes to determine the public float percentage by reference to the total number of securities of *that* class only. In the case of a PRC issuer with other shares in the class to which H shares belong e.g. A shares or unlisted shares, only the H shares held by the public would be included in the numerator in calculating an issuer's public float percentage. A shares or unlisted shares (as the case may be) would, however, be included in the denominator.

We welcome the proposals as we agree that the focus should be on the shares that contribute to the "open market" in the trading of listed securities in Hong Kong. Whilst the liquidity in another market would be useful information for investors in Hong Kong, if the shares are not fungible with the shares that are traded on the Exchange, the liquidity in the other market would have reference value only.

We suggest the Exchange could also consider that, whilst theoretically shares that are listed on another securities exchange and are fungible with the shares that are traded on the Exchange can contribute to the "open market" in the trading of listed securities in Hong Kong, in reality, whether shares listed on the other securities exchange would be transferred to Hong Kong for trading on the Exchange, and even if so, it takes time to transfer the shares from the other exchange to Hong Kong for trading on the Exchange, the actual impact on the liquidity in Hong Kong may not be as significant or relevant. This observation would be relevant to issuers who have primary listing on say a U.S. securities exchange or the Singapore Exchange, and on the Exchange.

In addition, this change would have particular impact on the calculation for existing A+H share listed issuers. For example, if an A+H share issuer currently satisfies the on-going minimum public float requirement by reference to the A shares and H shares held in public hands, if the calculation would be changed to looking at only the H shares held in public hands (in terms of the numerator), depending on what would be the change to the on-going public float requirement, this issuer may not meet the minimum H share public float that is required. Accordingly, such impact would need to be taken into account with the review and proposed amendments over the on-going public float requirements.

2. Initial public float

In response to Question 3

The Exchange proposes to introduce a tiered (Tier A to Tier D) range of initial public float thresholds ranging between 5% and 25% of the relevant class of securities new to listing, which provide higher certainty to listing applicants as to the applicable public float requirements and remove the unfairness that may exist in marginal cases. Under the current regime, in some cases where the listing applicant intends to apply for a public float waiver below 15%, there has been uncertainty as to the applicable public float threshold to be stipulated under the waiver as it is subject to the Exchange's discretion and would be considered by the Exchange on a case-by-case basis. The certainty of applicable public float requirement under the proposal would be helpful in allowing such listing applicants to adjust the offering structure due to fluctuating market conditions or otherwise shortly before the commencement of offering without the need of seeking the Exchange's consent in amending the public float waiver application. In general, we welcome the proposal on introducing a tiered range of initial public float.

In terms of the change proposed for each tier:

(a) with respect to Tier C and Tier D, we agree that lowering the percentage to 10% and 5% may increase the attractiveness of the Exchange as a listing venue for large cap and mega cap issuers. We note that, for Tier C, the minimum public float value of HK$4.5 billion is higher than the minimum HK$3 billion H share value that is proposed for A+H share issuers or issuers with other share class(es) listed overseas (see paragraph 162 of the Consultation Paper). From a consistency standpoint, we suggest that the Exchange could consider reducing the minimum public float value for Tier C to closer to HK$3 billion (in this regard, please also refer to our observation at paragraph 4 below); and

(b) with respect to Tier D, we note that the minimum value is rather high at HK$7 billion. Based on our knowledge, there is only a handful of listed issuers with primary listing on the Exchange whose permitted minimum public float (based on a specific waiver granted at the time of listing) is lower than 10% and not all of them whose value of the initial public float is at or more than HK$7 billion at the time of listing. Accordingly, if this minimum value could be lowered, it will give more latitude for the Exchange to attract more potential mega cap issuers. Looking at Figure 1 of the Consultation Paper with the comparison with other exchanges, the Exchange may consider lowering this minimum value to US$5 billion. We feel that this threshold is sufficiently high to capture the mega cap issuers, whilst give more flexibility to cater for market conditions that are relatively more challenging.

Taking into account the above comments, one option that the Exchange may consider is to adjust the tiers to that presented in the Appendix to this letter. We feel that such option (i) is consistent with the rationale set forth in paragraph 85 of the Consultation Paper; (ii) adapts the concept that the minimum value of HK$3 billion as H share value being considered sufficient for A+H share issuers or ; issuers with other share class(es) listed overseas; (iii) the threshold of HK$20 billion be qualified for a 15% public float, is already twice the value of the existing threshold of HK$10 billion; and (iv) lowering the overall maximum threshold to US$5 billion to allow more flexibility and to cater for the situation where the overall Hong Kong market is subject to more challenging conditions.

3. Ongoing public float

The Exchange seeks views on the appropriate ongoing public float requirements, including whether issuers should be allowed additional flexibility to maintain a lower public float level after listing.

As a general point, we welcome the proposal of reviewing the ongoing public float requirements as the present time may be a good time and opportunity to review this part of the Rules, in light of evolving market conditions and dynamics, and with a view to increase flexibility for issuers and therefore increasing the attractiveness of the Exchange as a potential listing venue. Whilst, at the same time, it would be important to balance the considerations for ensuring sufficient liquidity in the Hong Kong market to project the interest of the investing public and to reduce the risk of market abuse.

The general observation is that the Hong Kong market has been subject to substantial pressures and challenges over recent years, and many listed issuers have to undertake corporate actions to try to ease some of the pressures. In addition, the market valuation of many listed issuers has been subject to significant re-adjustment, making these issuers attractive takeover targets of potential offerors.

In our experience, we have seen increased difficulties and complexities when considering and structuring certain corporate actions when the issuer/potential offeror needs to ensure that the issuer is able to maintain the minimum ongoing public float after the corporate action. In some cases, the concern over the ability to maintain the minimum ongoing public float may hinder an issuer/potential offeror from implementing the corporate action, even though the proposed corporate action would have been considered to be in the interest of the issuer and the issuer's shareholders as a whole. For examples:

(a) Over the last few years, the share price of many listed issuers has been subject to substantial downward pressure. Many issuers were interested to undertake on-market share repurchases to help support the share price. This is particularly so with the introduction of the treasury share regime under the Rules. However, if an issuer does not have any buffer in terms of public float (and many of these issuers were listed a long time ago and adopt the minimum threshold of 25%), it will not have any opportunity to carry out any on-market share repurchase. If the issuer only has a very small headroom for the public float, it would also make it impractical to adopt an automatic share repurchase program which is of a sufficient size and duration (which is the preference of the issuer, the broker, market participants and the market in general). Repurchasing shares from connected person(s) through an off-market share buyback would not have the same impact on supporting the share price as on-market share repurchases.

(b) For PRC issuers with H shares listed on the Exchange (and unlisted domestic shares), if the share price of their H shares has been depressed for quite some time, these issuers are less willing to issue new H shares to raise equity funds. In some cases, their key shareholders (who hold the unlisted domestic shares) are willing to subscribe for new unlisted domestic shares at a value that is higher than the H shares price to support the issuer. In some other cases, these PRC issuers are state-owned enterprises and they are not able to issue new H shares at the current market price because it may be below its net asset value per share. Accordingly, their alternative for equity fundraising is to issue unlisted domestic shares at an appraised value to its key state-owned or domestic shareholders. This option would not be available to such issuers if they do not have any buffer in terms of the H share public float. Debt fundraising was also considered difficult and too costly given the high interest rate environment.

(c) A public float issue would be particularly challenging to resolve if the issue is caused by (i) an unsolicited takeover offer or (ii) a large shareholder buying additional shares from the market and taking its shareholding from below 10% to 10% or above. In situation (i), in a friendly takeover offer scenario, if the offeror wishes to maintain the issuer's listing status, the offeree board would apply for a public float waiver immediately upon the closing of the offer (hence to avoid the trading suspension). However, in the context of an unsolicited general offer (or a hostile takeover), given that the offeror would not have control of the offeree board immediately upon the close of the offer, a public float waiver could only be applied for after a shareholders' requisition and this will likely result in trading suspension until the shareholders' requisition is successful and the offeree board has successfully applied for a public float waiver. In situation (ii), it may take a long time for the issuer to find new placement investors to restore the public float (as the deficiency in public float will suddenly become 10%), or the shares may need to be issued at a sizeable discount to attract investors but such action will create sizeable value dilution impact on all shareholders and therefore is very costly to the issuer and its shareholders.

If an issuer does not meet the requisite minimum public float, the impact on liquidity will depend on the actual percentage of deficiency, and a small gap should not have noticeable impact on liquidity nor noticeable increase in the risk of market abuse. However, the fact that the issuer does not meet the minimum public float level (hence a substantive risk of trading suspension) would give rise to other issues, such as a breach or potential breach of debt covenants. Even though the Exchange may consider granting an interim waiver (hence allowing a longer grace period for the issuer to restore its public float), the fact that the interim waiver is only for a limited time and the uncertainty around the renewal of the waiver (hence the substantive risk of trading suspension) are sufficient to raise concern of lenders/bondholders and they may use this to trigger an event of default under loan agreements or bond terms (or gain leverage over the issuer). This is particularly challenging for the issuer to manage when the deficiency in public float is caused by third party actions that are outside the issuer's control.

If the on-going public float requirement could be relaxed to some extent, this will give more latitude to issuers and other relevant parties when considering and structuring corporate actions that, whilst may result in an impact on public float, have other benefits to the issuer and its shareholders as a whole.

We also suggest the Exchange assess how to adjust the on-going public float requirement for existing issuers if the requirement will be relaxed for new issuers to ensure equality in treatment.

4. Initial Free float

In response to Question 6

The Exchange proposes to ensure that a certain portion of shares in public hands can be freely traded upon listing to help provide liquidity. For a new applicant, shares held by the public and not subject to disposal restrictions at the time of listing must either:

- represent at least 10% of the total number of issued shares in the class for which listing is sought, with an expected market value of at least HK$50 million; or
- have an expected market value of at least HK$600 million.

We welcome the proposal to codify and generalise the requirement to increase certainty and consistency, as we understand that in practice, the HK$600 million initial free float requirement is applied in some listings.

Whilst we understand that the reference to HIK$600 million as an initial "free float" requirement under the Rules is a concept that was dated back some years ago, such reference to HK$600 million does not seem entirely consistent with the middle range of the initial public float requirement under the proposed tiered approach. If the view is that 10% of the shares for which listing is sought could be considered to be sufficient free float, if we take the reference to HK$4.5 billion market value of public float under Tier C in paragraph 78 of the Consultation Paper, 10% of HK$4.5 billion would be HK$450 million. We suggest the Exchange could consider assessing an appropriate level of free float (in terms of market value) by reference to the market values that are adopted under the tiered approach for initial public float.

Further, in practice, it would be more difficult for H share issuer (with unlisted domestic shares) to meet the 10%/HK$600 million threshold requirement, than the below lower initial free float threshold for A+H share issuers. This is because, for H share issuer (with unlisted domestic shares), in addition to contractual lock-up restrictions on cornerstone investors, certain existing shareholders of the issuer (e.g. those who have converted their domestic shares to H shares at the time of listing to facilitate the meeting of the minimum initial public float requirement) are also subject to lock-up restrictions under PRC laws. Whilst for A+H share issuers, the locked-up shareholders would likely be the cornerstone investors only.

With respect to A+H share issuers, the proposed free float requirement is at least 10% of the total number of H shares for the purpose of the calculation of the free float percentage (without a minimum market value). We would like the Exchange to clarify the understanding that, when combining with the proposals set forth in paragraph 162 of the Consultation Paper, this free float requirement would mean either 1% of the total number of shares in the class to which H shares belong or HK$300 million in excepted market value. We suggest the Exchange to consider these thresholds and assess whether this would be sufficient initial free float in the Hong Kong market. For example, if the initial free float requirement is reduced from HK$600 million to HK$450 million, it will narrow the gap with HK$300 million and seems more reasonable as a differential in treatment between A+H share issuers and H share issuers (with unlisted domestic shares).

5. Minimum thresholds on the relative proportion of listed shares applicable to A+H issuers and other cross-border listings

In respect to Question 7

The Exchange proposes that, for a new applicant that is a PRC issuer with other listed shares (such as an A+H issuer), the H shares for which listing is sought on the Exchange must either:

- represent at least 10% of the total number of shares in the class to which H shares belong (excluding treasury shares); or
- have an expected market value of at least HK$3 billion at the time of listing.

For a new applicant that is an issuer with other share class(es) listed overseas, the class of shares for which listing is sought on the Exchange must either:

- represent at least 10% of the total number of issued shares (excluding treasury shares); or
- have an expected market value of at least HK$3 billion at the time of listing.

In general, we welcome the proposal to have lower thresholds that apply to PRC issuers with other listed shares (such as an A+H issuer). This is because, given that such issuers are already listed on another exchange, in order to attract such an issuer to come to Hong Kong to undertake a "follow-on" offering, we should offer more flexible and attractive thresholds to facilitate an offering of such nature.

Whilst we understand the basis and rationale for the Exchange in determining the HK$3 billion threshold (as stated in paragraph 170(b) of the Consultation Paper), we would like to give some additional information based on our understanding for the Exchange's consideration:

- there are approximately 5400 A-share listed companies, and there are around 10% of these listed companies with market capitalisation that is HK$30 billion (or more); and
- there are approximately 150 A-share listed companies who are also listed on the Exchange.

Based on the above information, if the intention is to attract more A-share listed issuers for listing their H shares on the Exchange, it would seem that the threshold of HK$3 billion may only capture a small portion of the A-share listed issuers, whilst the other A-share listed issuers would need to meet the 10% threshold. Given that an H share offering is likely viewed as a "follow-on" offering from the perspective of these A-share listed issuers, it would seem that a 10% threshold may be considered too high (this is especially so where the net proceeds raised from an H-share offering would need to, as we understand, be transmitted back to the Mainland China and kept in the issuer's foreign currency bank account within Mainland China before they could be applied to their specific uses (whether inside or outside of Mainland China). In addition, as an A-share listed company, the PRC regulators have tight regulations and controls over the use of proceeds from equity fundraisings, A-share issuers very often adopt a prudent approach in determining the fundraising amount and their specific uses by reference to the A-share regulations as this may be the expectation of their shareholders.

Lastly, we suggest the Exchange to consider clarifying whether, if an A+H share issuer satisfies the 10%/$3 billion threshold proposed under paragraph 162 of the Consultation Paper (or the relevant final threshold), it will be considered to have fulfilled its bespoke initial public float requirement (as this point is not very clear in light of paragraph 79(a) of the Consultation Paper).

6. Placing tranche

<u>In respect to Questions 9 and 10</u>

The Exchange proposes a minimum 50% allocation (of shares initially on offer) to bookbuilding placing tranche (except for Specialist Technology Companies) and removing the requirements that there must be: (a) not fewer than three holders to each HK$1 million is placed; and (b) a minimum of 100 holders in an IPO placing tranche.

We welcome the above proposed changes.

7. Public subscription tranche

<u>In respect to Question 11</u>

The Exchange proposed that listing applicants should adopt either:

- *Mechanism A:* mandatory initial allocation of 5% of the offer shares to the public subscription tranche, and mandatory clawback mechanism that increases the allocation to up to 20%; or

- *Mechanism B:* minimum initial allocation of 10% of the offer shares to the public subscription tranche without clawback mechanism (not available to Specialist Technology Companies).

We welcome the above proposals. We agree that by limiting the extent of the public tranche allocations, the risk of mispricing would be minimised. In particular, public investor demand could be over-exaggerated as public investors do not need any costs to get margin loans under the current subscription arrangement – as they only pay the total subscription price after allocation is released, instead of having to pre-fund the total subscription price at the time of application like before.

8. Pricing Flexibility Mechanism

<u>In respect to Question 13</u>

The Exchange proposes to permit upward pricing flexibility of up to 10% above top of offer price range; and consult on either:

- retain the current requirement that the top of the initial offer price range must be set at not more than 30% of the bottom of that range; or
- amend the current requirement to require the top of the initial offer price range to be set at not more than 20% of the bottom of that range.

We would like to suggest that the Exchange considers the following as a default position: an issuer can price 10% above top end offer price and 10% below low end offer price, with top of initial offer price range must be set at not more than 30% of the bottom range.

We believe setting this default position allows flexibility to all issuers and stakeholders, and aligns the Exchange with the US markets. The Exchange would need to educate the market at the initial stage (and this may take some time), however, in the long run, a default position can:

- avoid any unnecessary lengthy disclosure in respect of the mechanism (instead just a one pager disclosure at the start can do);
- avoid confusion in the market as to who can price above or below; and
- avoid any stigma to issuers who do not adopt upward pricing flexibility.

We hope the above provide some useful information for your further consideration. Should the Exchange wish to discuss any of our comments please contact:

[redacted]

Yours faithfully

[redacted]

Clifford Chance

Encl.

Appendix

Tier	Expected market value of the relevant class of securities at the time of listing	Minimum percentage of such class of securities to be held in public hands at the time of listing
A	≤ HK$6 billion	25%
B	> HK$6 billion to ≤ HK$20 billion	The higher of: (i) the percentage that would result in the expected market value of such securities in public hands to be HK$1.5 billion at the time of listing; and (ii) 15%
C	> HK$20 billion to ≤ HK$50 billion	The higher of: (i) the percentage that would result in the expected market value of such securities in public hands to be HK$3 billion at the time of listing; and (ii) 10%
D	> HK$50 billion	The higher of: (i) the percentage that would result in the expected market value of such securities in public hands to be HK$5 billion at the time of listing; and (ii) 5%