SLAUGHTER AND MAY/

CLIENT BRIEFING

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PRACTICAL CONSIDERATIONS IN RESPECT OF CMI AND OC APPOINTMENT AND FEE ARRANGEMENTS IN BOOKBUILDING AND PLACING ACTIVITIES IN ECM TRANSACTIONS

Overview

The new conduct requirements for bookbuilding and placing activities in both equity capital market (**ECM**) and debt capital market (**DCM**) transactions in Hong Kong under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the **SFC**) (the **New Code Provisions**) became effective on 5 August 2022 (the **Effective Date**). In our previous briefing, we discussed the key requirements under the New Code Provisions and in particular what ECM intermediaries should do in order to ensure compliance with the New Code Provisions.

On 22 April 2022, The Stock Exchange of Hong Kong Limited (the **Exchange**) published an information paper summarising the consequential amendments (the **Rule Amendments**) to the Rules Governing the Listing of Securities on the Exchange (the **Listing Rules** or **LR**) to reflect and complement the New Code Provisions. In May 2022, the Exchange also published (and later updated in August 2022) Frequently Asked Questions No. 077-2022 in respect of the Rule Amendments (the **HKEX FAQs**) and the SFC posted FAQs intended to provide guidance on the New Code Provisions on its website (the **SFC FAQs**).

Implementation of the New Code Provisions and the Rule Amendments could well be a challenge for an Overall Coordinator (**OC**) or a Capital Market Intermediary (**CMI**). In this briefing, we focus on some practical considerations relating to CMI and OC appointment and fee arrangements.

A. CMI and OC Appointment

1. "Marketing" vs. "Market Sounding"

Under the New Code Provisions, an intermediary must be appointed under a written engagement prior to conducting certain specified activities, including "placing activities". "Placing activities" is defined as marketing or distributing shares to investors pursuant to bookbuilding activities (including collating investors' orders).

The scope of "marketing" is not clearly defined by the SFC, but excludes "market sounding" that is conducted to gauge investors' interest before the issuer has decided to pursue an offering. The demarcation between the two is whether an issuer makes a decision to pursue an offering. "Market sounding" conducted before an issuer has decided to pursue an offering does not require formal engagement of an intermediary. CMIs (including OCs) should clarify with the issuer directly and document the issuer's intention before conducting any "marketing" or "market sounding" in order to avoid any cases of doubt. Indeed, finalising the terms of engagement as early as possible is favourable to CMIs, as it enables them to commence the bookbuilding and placing activities earlier in the process and reduces uncertainty around the scope of marketing activities.

In addition, where the purpose of an intermediary approaching an investor or distributing information such as teasers to an investor is to market shares to investors with a view to generating or collating investors' orders, it is likely to be considered "marketing" and the intermediary should be formally engaged before doing so.

2. "Sponsor-OC" vs "Sponsor" + "OC"

A Main Board listing applicant must appoint at least one sponsor-OC. In order to become a sponsor-OC for the purpose of LR3A.43, an intermediary and/or its group company must be appointed as both sponsor and OC at the same time, and the appointment must be made at least two months before the submission (or re-filing) of the listing application. Accordingly, if an intermediary (or its relevant group company) has been appointed as a sponsor and subsequently as an OC, it will only be acting as a sponsor and an OC for the IPO, but not a "sponsor-OC" under LR3A.43.

All sponsor-OC criteria (including the sponsor independence requirement) must be fulfilled for an OC to qualify as a sponsor-OC. This means that each sponsor-OC must either be an independent sponsor or within the same group of companies as an independent sponsor. As such, there cannot be a sponsor-OC that is not independent.

For completeness, there can in addition be a sponsor that is not an OC, or an OC that is not a sponsor, or a non-independent sponsor that is also an OC (although that intermediary will not fulfil the criteria of a "sponsor-OC").

3. Title of syndicate members

Intermediaries may still be awarded titles currently being used in the market (*e.g.*, global coordinator, bookrunner, etc.) and identified by these titles in the listing documents, but they should approach with caution being awarded titles that appear to be inconsistent with how their roles are defined under the New Code Provisions. Irrespective of the marketing title, a CMI which conducts any of the OC-specific activities will be regarded as an OC and is required to comply with the conduct requirements applicable to an OC under the New Code Provisions and the Rule Amendments.

Similar to the roles and responsibilities of an OC as required under Para 21.4.4 of the New Code Provisions, a joint global coordinator typically acts as a lead underwriter to advise and guide the issuers throughout the bookbuilding and placing process. Therefore, where a joint global coordinator is engaged to carry out such OC-specific activities, it should be appointed as an OC.

B. Fee arrangement in written agreement

Under the New Code Provisions, the written engagement of a CMI or an OC must specify the fixed fees to be paid to the CMI or OC ("**Fixed Fees**") as a percentage of the total fees (including the Fixed Fees and discretionary fees ("**Discretionary Fees**")) to be paid to all syndicate CMIs ("**Total Fees**"), as well as the time schedule for payment of the fees to the CMI or OC.

1. "Fixed Fees"

In classifying a fee as a "Fixed Fee", there are two general principles set out in the HKEX FAQs:

(a) the engagement agreement should enable the CMI (including an OC) to **ascertain the minimum amount of fees payable** to it which is **not subject to the discretion of the issuer** (other than because of changes in the offer price or total offer size); and

(b) both the **fee entitlement** and the **identity** of the payee CMI (including an OC) must be set forth in the written engagement.

Set out below is some useful guidance provided by the Exchange on the formulation of Fixed Fees:

FIXED FEES FORMULATION	EXCHANGE'S VIEWS
(a) "No less than [x]% of the Total Fees"	The [x]% would be considered as Fixed Fees, and any fees above [x]% would be considered as Discretionary Fees.
(b) "No more than [x]% of the Total Fees"	This will not be acceptable, as there is no certainty as to the minimum amount of fee that the CMI may get.
(c) A percentage range of the Total Fees	The minimum fee prescribed by the range would be regarded as the Fixed Fees of the CMI, while any additional fees within the range would be regarded as its Discretionary Fees.
(d) Tiered commission structure	For tiered commission structures where a higher commission rate will apply when the deal is priced higher, the minimum fee prescribed by the tiered commission structure would be regarded as the Fixed Fees, whereas any fees above that minimum fee would be regarded as Discretionary Fees. Such fee arrangement should be clearly disclosed in the IPO listing document.
(e) Upward adjustment of Fixed Fee subject to the issuer's discretion	The Fixed Fees entitlement expressed in an engagement may be increased subject to the discretion of the issuer (other than due to changes in the overall offer size or offer price). However, the discretionary portion of such fees will be regarded as Discretionary Fees.

FIXED FEES FORMULATION	EXCHANGE'S VIEWS
(f) Downward adjustment of Fixed Fee pursuant to a re-allocation mechanism in the event more syndicate CMIs than initially budgeted are appointed	Not acceptable, as the fee percentage of the OC and the extent of the subsequent reduction are unclear at the time of its engagement, and there is no certainty as to the minimum amount of fixed fees that the OC may get.

It should be noted that the interpretation of a fee as "fixed" or "discretionary" for the purpose of LR3A.34 and LR3A.36 might not necessarily be the same as the legal nature of the fee from the perspective of the issuer, e.g., under contract law. For example, if an engagement agreement specifies a contractual obligation to pay a fee of 3% of the gross proceeds from the offering to all OCs where the actual allocation to each OC is to be determined at an issuer's discretion, the fee is not a "fixed fee" from the perspective of each OC for purposes of LR3A.34 and LR3A.36, but the total amount of such fees payable to all OCs remains the issuer's contractual obligation and any disclosure of such fee in the listing document should reflect this nature.

The Fixed Fees can be expressed in other forms depending on the commercial negotiation and preferences of the parties involved. Intermediaries should, however, consider whether such forms would contradict the general principles or introduce uncertainty into the fixed fee entitlement of the CMI. In particular, where any part of the Fixed Fees is regarded as Discretionary Fees, this may have an impact on whether the fee split ratio will significantly deviate from the market practice of 75%:25% - in the case of significant deviation, the SFC may make enquiries.

2. "Discretionary Fees"

The Exchange clarified in the HKEX FAQs that "Discretionary Fees" refers to any fee other than a Fixed Fee. As discussed above, a key principle of classifying a fee as a Fixed Fee is that it should not be subject to the discretion of the issuer. As such, where the intended Fixed Fee is subject to the discretion of the issuer, it would be regarded as a Discretionary Fee. For example, if a fixed percentage of the Total Fees as specified in the written engagement must be paid by the issuer to all CMIs, but the precise allocation to each CMI is at the sole discretion of the issuer, such fee would be regarded as a Discretionary Fee.

Unlike Fixed Fees, the payment of Discretionary Fees to any syndicate member is at the absolute discretion of the issuer and therefore it would be acceptable for the discretionary fee percentages to be subject to language such as "up to" or "no less than" a particular percentage.

3. Material change to previously submitted information on fee arrangements

Where any change proposed to the original fee structure may potentially result in the contravention of the Listing Rules or the New Code Provisions, regulators should be consulted as early as possible and before the changes are made.

Where there is any material change to previously submitted information, including (i) the aggregate of the fees and ratio of fixed and discretionary fees paid or payable to all syndicate members required to be included in the application proof submitted for vetting purposes or (ii) information including, among others, the allocation of the fixed portion of the fees paid by the issuer to each OC and the ratio of fixed and discretionary fees to be paid to all syndicate CMIs required to be submitted with the "4-day" submission, the Exchange should be notified and be provided with the updated information and the reasons for such change as soon as practicable.

Where the regulators become aware that a material change has been made to the fee arrangement, the regulators will assess such change on a case-by-case basis having regard to the scale of, and the reasons for, the change. Depending on the circumstances of the case, the regulators might make enquiries to assess whether the original incentive arrangements for the CMIs involved have been fundamentally changed and constitute a new engagement if, for example, the fixed fee entitlement to some existing OCs is reduced after allocating a significant percentage of the fee pool to CMIs appointed at a very late stage.

For an OC, if the material change to the terms of its engagement is treated as constituting a new engagement, the date on which such material change is made will be regarded as the date of its appointment, thereby potentially causing delay to the listing timetable.

There are situations where subsequent material adjustments to fees may be regarded as justifiable, such as the resignation of an OC, which necessitates a re-allocation of fees, or a significant reduction in offer size, which results in a commercial negotiation of revised fee arrangements.

4. Entering into supplemental engagement agreement for re-compliance

If the fixed fee entitlement of a syndicate CMI (including an OC) is not presented as an acceptable fixed fee formulation, then such CMI will not be considered as having been appointed in compliance with the Listing Rules. A supplemental engagement can be entered into in order to re-comply with the Listing Rules, but the Exchange will consider such appointment as having commenced on the date of the supplemental engagement, subject to certain transitional arrangements.

C. Conclusion

Overall, the New Code Provisions and the Rule Amendments will likely have a substantial impact on the timing for appointment and the fee structure and arrangements for intermediaries. In particular, intermediaries should refer to Paras 21.3.2 and 21.4.1(a)(ii) of the New Code Provisions, LR3A.34 and LR3A.36, and FAQ Nos. 10, 10A-10G, 11, 11A, 12 and 13 of the HKEX FAQs when formulating fee arrangements.

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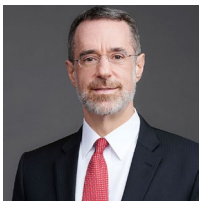

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