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HONG KONG STOCK EXCHANGE INTRODUCES IPO "DOUBLE DIPPING" EXEMPTION

Summary

The Stock Exchange of Hong Kong Limited (the **Exchange**) published a revised Guidance Letter HKEX-GL85-16 (the **Revised Guidance**) introducing an exemption to permit existing shareholders (including pre-IPO investors) and cornerstone investors of a new listing applicant to subscribe for or purchase further securities in an IPO (i.e., to "double dip") under certain specified conditions (see Size Exemption Conditions below).

Existing shareholders of an IPO applicant (other than directors, CEO or controlling shareholder) and/or their close associates and cornerstone investors are now allowed to "double dip" in the IPO if the offer size is at least HKD1 billion and the aggregate allocation to all existing shareholders and their close associates does not exceed 30% of the offering.

The Revised Guidance took immediate effect from 21 November 2023 and is summarised in the new comprehensive "Guide for New Listing Applications", which consolidates and enhances all currently effective guidance letters and listing decisions relating to a new listing (the **New Listing Guide**). The New Listing Guide will come into effect on 1 January 2024.

The objective of the new exemption (the **Size Exemption**) is to provide more flexibility to independent investors and to allow greater IPO participation by independent investors, which should in turn contribute to a more robust IPO price discovery process and help ensure a final offer price that better reflects market opinion.

Background

Rule 10.04 of the Rules Governing the Listing of Securities on the Exchange (the **Listing Rules**) provides that an existing shareholder may only subscribe for or purchase any securities of a listing applicant in an IPO if the conditions in Rules 10.03(1) and (2) are fulfilled, namely that:

(a) no securities are offered to the existing shareholder on a preferential basis and no preferential treatment is given to the existing shareholder in the allocation of the securities; and

(b) the minimum prescribed percentage of public shareholders required by Rule 8.08(1) of the Listing Rules is achieved.

Prior to the introduction of this reform, where existing shareholders (or their close associates) propose to subscribe for or purchase further securities under the placing tranche of an IPO in circumstances other than pursuant to a pre-existing contractual anti-dilution right, the Exchange would presume that preferential treatment had been given to these investors, and the Exchange's waiver from strict compliance with Rules 10.03 and 10.04 would be required. The Exchange would only give its consent for allocation of securities to such existing shareholders or their close associates if certain conditions could be met, including, for instance, a holding of less than 5% voting power before listing, no power to appoint directors and no other special rights, etc. (the **Existing Shareholders Conditions**), failing which the Exchange would presume preferential treatment and the subscription would not be permitted.

Further, cornerstone investors would not be allowed to subscribe for or purchase additional shares under the placing tranche, as the Exchange would presume preferential treatment had been given to those investors due to their special status in the company.

The new Size Exemption

With the Revised Guidance coming into effect from 21 November 2023, the Exchange introduced an exemption under which a subscription for, or purchase of further securities by, existing shareholders (including pre-IPO investors) and/or their close associates and cornerstone investors of a listing applicant in its IPO will be permitted if it can be demonstrated that an IPO meets the new size exemption conditions (the **Size Exemption Conditions**), namely that:

- the offer (excluding any over-allocation) has a total value of at least HKD1 billion;
- the allocation to all existing shareholders and their close associates (whether as cornerstone investors and/or as placees) as permitted under the exemption does not exceed 30% of the total number of securities offered – the listing applicant may go beyond 30% provided that it can demonstrate that such further allocations should be permitted having regard to the circumstances (e.g., being eligible for one of the other exemptions set out in the Revised Guidance, where applicable); and
- each director, chief executive, controlling shareholder and (in the case of a PRC issuer) supervisor, of the listing applicant have confirmed that the listing applicant's offer securities are not allocated to them or their close associates under the exemption.

The New Listing Guide provides that the Size Exemption will apply subject to the disclosure of details of the allocation in the listing document and/or the allotment results announcement.

Under the new Size Exemption, an existing shareholder and/or its close associate may also be a placee and/or cornerstone investor in the IPO, whilst a cornerstone investor may be a placee in the IPO.

Where the new Size Exemption Conditions apply, the Existing Shareholders Conditions do not need to be fulfilled, but consents and waivers from the Exchange are still required to be obtained.

Where allocations will/may be made to existing shareholders or cornerstone investors who are core connected persons of a listing applicant pursuant to the Size Exemption Conditions, the Exchange will grant a related waiver from strict compliance with Rule 9.09(b) of the Listing Rules in respect of such allocations over the period from four clear business days before the expected hearing date until listing.

For biotech companies, specialist technology companies and SPAC promoters, the alternative conditions as set out under Guidance Letters HKEX-GL92-18, HKEX-GL115-23 and HKEX-GL113-22 respectively continue to apply but the Size Exemption is not applicable.

Other Exemptions from the Existing Shareholders Conditions

Apart from the new Size Exemption, the existing exemptions to the Existing Shareholders Conditions continue to apply, including providing exemptions if (i) the securities are undersubscribed at the low end of the IPO price, (ii) existing shareholders purchase securities based on an anti-dilution provision and (iii) securities are allocated to close associates of existing shareholders who are PRC governmental bodies. In addition, if the applicant is listed on another stock exchange, the Exchange may continue to grant consent and waiver for an existing shareholder which is interested in 5% or more voting right if it is a genuine, independent and public investor.

Conclusion

This relaxation of the double dipping restriction is a much-welcomed reform, in particular where the market has recently been struggling with securing sufficient investor demand in connection with the bookbuilding process. This reform will provide greater flexibility for listing applicants and underwriters to allocate securities to independent investors during the bookbuilding process and will help facilitate the marketing efforts for Hong Kong IPOs, which should improve the attractiveness of the Hong Kong market in the long run.

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