Statement on recent GEM listing applicants

13 Mar 2017

1. On 20 January 2017, the Securities and Futures Commission (**SFC**) issued a guideline (**Guideline**) to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks and a joint statement (**Joint Statement**) with The Stock Exchange of Hong Kong Limited (**Exchange**) regarding the price volatility of GEM stocks. In light of our experience of recent GEM IPO activity, the SFC provides this update and further guidance on our regulatory approach. In particular, this includes the way in which the SFC raises concerns directly with listing applicants, sponsors, underwriters and placing agents, and takes decisions pursuant to the powers granted to it under the Securities and Futures Ordinance.

Background

2. Out of 45 GEM listings in 2016, 36 were listed by way of placing only and nine included a public offer tranche. The average first day share price change (as against the offer price) for the placing-only GEM IPOs was an increase of 656%, with the highest one increasing 2005%. Out of these 36 placing-only listings, 30 experienced a 100% or more increase in share price on their trading debut, nine of which saw their prices tumble by more than 90% from their first day closing price as at 31 January 2017 and another 10 saw their prices drop by between 50% and 90% as of the same date. The shareholdings of the top 25 placees for the placing-only GEM listings ranged from 70.0% to 99.6% of the total number of placing shares. The number of placees for these 36 placing-only listings ranged from 107 to 578.

3. For GEM listings in 2016 with a public offer tranche, the number of valid public subscriptions received ranged from 647 to 17,031 applications. The average first day share price change for these nine listings was a 22% increase.

4. After the issue of the Guideline and the Joint Statement, five GEM stocks have been listed to date, of which two had a public offer tranche and one was a pure public offering. The average price change for these GEM stocks at the close of the first day trading (excluding one stock which was suspended from trading after the close of the first day morning session) was an increase of 4.2%.

Our Approach to GEM Listing Applications

5. Where there are regulatory concerns about a listing application, the SFC or the Exchange may raise enquiries before dealings in the shares commence. The SFC may object to a listing under section 6(2) of the Securities and Futures (Stock Market Listing) Rules (**SMLR**), for example, where it appears to the SFC that the applicant has failed to comply with a Listing Rule, or where it would not be in the interest of the investing public or in the public interest for the shares to be listed.

6. After the issue of the Guideline and the Joint Statement, four listing applicants delayed their listing plans. In each of these four cases, the SFC had concerns about the applicants' compliance with the open market requirement and raised enquiries in that regard as well as their placing agents' compliance with the Guideline. Those enquiries mainly focused on the overall strategy and allocation basis leading to the high shareholding concentration, and the "know your client" procedures conducted by the placing agents in view of the potential red flags identified from the placee lists submitted in support of their listing applications (for example, multiple groups of placees sharing the same addresses and establishment of fund source as referred to in paragraph 13 of the Guideline).

7. In view of the findings in paragraph 2 above, the SFC reminded listing applicants who adopted a placing-only method of listing of their obligation to ensure that the conditions exist for an open market to develop at the time of listing. The SFC also drew their attention to the possible exercise of its power of suspension under section 8 of the SMLR if it notes irregularities in the trading of shares after listing.

8. In one case where the listing applicant proceeded to trading, a section 8(1) SMLR notice was issued by the SFC to direct the Exchange to suspend all dealings in the shares. It appeared to the SFC that there may not have been an open market and that a suspension was necessary or expedient in the interest of maintaining an orderly and fair market in the shares of the company and in the interests of the investing public or for the protection of investors.

9. Once a suspension has been directed, the company is entitled to make representations to the SFC, as a result of which the SFC may maintain the suspension, delist the company or lift the suspension.

10. Historically, the SFC has most often directed suspension when it has identified evidence of possible and material breaches of the Securities and Futures Ordinance during the course of an investigation. Sufficient indicators that an open market does not exist, unusual trading patterns that may suggest possible market manipulation or evidence of false or misleading disclosures may also lead to suspension by the SFC.

11. A decision to suspend is taken to protect a broad range of market participants, including to protect potential investors from investing on an uninformed basis, while also weighing the effect on existing shareholders. The SFC will only intervene after careful consideration of the relevant facts and circumstances.

Open Market – Number of Placees not a Sole Factor

12. The SFC reiterates that it is the issuer's responsibility to ensure an open market under GEM Listing Rule 11.23 and the sponsor's responsibility to, inter alia, advise and guide the issuer in this respect.

13. The conditions for an open market do not exist only by virtue of a count of the number of shareholders. The number of shareholders is only one factor that will be taken into account when determining whether the shareholdings of a GEM listing applicant are overly concentrated. Other factors include those relating to the placing process as mentioned below.

14. The statistics in paragraphs 2 and 3 above suggest that having a public offer tranche is more likely to achieve a shareholder base which ensures a fair and orderly market.

Approaching all Active Clients

15. Placing agents are reminded that they should have a robust marketing and placing strategy and an allocation basis with a view to achieving an open market in the offered securities, including an adequate spread of shareholders. A placing agent is generally expected to notify all of its active clients of each placing opportunity under paragraph 13 of the Guideline.

16. The SFC expects appropriate policies and procedures to be put in place to avoid any undue concentration of shareholdings and to maximise the likelihood of an open, fair and orderly market in the securities at the time of listing, which should include a marketing programme directed to a wide range of clients.

17. The SFC noted that certain placing agents have bought shares in the market for their existing clients shortly after the listing at a price substantially higher than the IPO price. This suggests that placing agents might not have approached all of their active clients who would be interested in buying shares in the IPO.

18. The SFC has a statutory objective to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry. Where appropriate, we will consider exercising our powers under the SMLR in order to promote this objective.

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