HKEX Consults on IPO Price Discovery, Open Market Requirements and HK OTC Market

In December 2024, the Hong Kong Exchanges and Clearing Limited (**HKEX**) issued its Consultation Paper on Proposals to Optimise IPO Price Discovery and Open Market Requirements (**HKEX Consultation Paper**) proposing significant reforms to the Hong Kong IPO offering process and the open market requirements. The HKEX Consultation Paper is also seeking feedback on the desirability of a Hong Kong OTC market.

The HKEX is requesting feedback on the proposals and has set a cut-off date for comments of 19 March 2025.

Part I: HKEX Proposals on Open Market Requirements

Proposed changes to the calculation of public float percentage

The "public float" requirement under the HKEX Listing Rules refers to the portion of an issuer's listed shares held by the public, expressed as a percentage. The HKEX requires a minimum public float of 25% — i.e., at least 25% of a listed issuer's issued shares (excluding treasury shares) must be held by the public; although the HKEX may allow a lower minimum public float for companies with a market capitalisation of HK$10 billion or more. In calculating the public float, the numerator represents the shares held by the public, while the denominator represents the total number of issued shares of the issuer, excluding treasury shares.

The HKEX has reviewed the existing public float requirements and noted that certain types of shares that are not publicly traded in the Hong Kong market (such as A shares and unlisted shares) are included in the calculation of the listed issuer's public float. Unlisted shares are included in the denominator portion of the formula, while listed A shares are included in both the numerator and denominator of the public float calculation. The HKEX considers that these shares do not contribute to the Hong Kong open market and proposes to revise the public float requirement.

It is proposing that the public float for securities new to listing will generally be calculated by reference to the total number of securities of that class only. This proposal will generally only impact issuers with other classes of shares (other than the class being listed). For PRC issuers, the HKEX Consultation Paper proposes that the numerator would only include its H shares, while the denominator would include its other issued shares that are in the class to which its H shares belong.[1] For other issuers with other share classes listed overseas, it is proposed that the

1 The share capital of a PRC issuer listed on the HKEX normally comprises H shares and domestic shares (listed or unlisted), that are both ordinary shares and are considered as one class of shares under PRC laws and regulations

numerator would only include the class of shares being listed in Hong Kong, while all classes of their issued shares will remain in the denominator for the purposes of the calculation.

The HKEX's proposals would also remove the requirements for:

- Shares carrying weighted voting rights (**WVR**) (which must be unlisted) to be included in the denominator when calculating the public float of issuers with WVR structures; and
- Promoter Shares and Promoter Warrants to be included in the denominator when calculating a SPAC's public float.

Minimum market value in public hands for HKEX listing applicants

The HKEX Listing Rules require that the securities of a new listing applicant held by the public have an expected market value of at least HK$125 million (or HK$45 million for GEM) at the time of listing. The HKEX is proposing to revise the relevant HKEX Listing Rules (Main Board Listing Rule 8.09(1) and GEM Listing Rule 11.23(2)(a)) to clarify that the minimum market value of the publicly held shares requirement applies to the securities *"for which listing is sought"*.

Revised definition of "the public"

The HKEX is proposing to revise the definition of "the public"[2] to additionally exclude:

- any person whose acquisition of shares has been financed directly or indirectly by the issuer (or a Core Connected Person of the issuer); and
- any person who is accustomed to take instructions from the issuer (or a Core Connected Person of the issuer).

If adopted, shares held by a trustee on behalf of share scheme participants of a listed issuer will no longer be publicly held shares. However, it is proposed that shares held by an independent trustee on behalf of the participants of an independent share scheme (i.e. shares granted to an independent grantee that remain unvested under the share scheme) would continue to be regarded as publicly held shares.

Introduction of tiered initial public float thresholds

The HKEX Consultation Paper proposes a new tiered structure for the initial public float threshold based on the expected market value of the class of securities for which listing is sought at the time of listing. Currently, new listing applicants are required to have a minimum public float of 25%. Large cap issuers — i.e., those with an expected market capitalisation at the time of listing of at least HK$10 billion — can apply for a lower percentage of public float of between 15% and 25%. The HKEX considers that the new tiered structure would provide greater certainty for large cap listing applicants whose applications for a lower minimum public float are decided on a case-by-case basis. The HKEX also notes that its initial public float requirement is higher than those of other international stock exchanges and that the proposed tiered thresholds would bring its requirement closer to those of its competitors.

The table below sets out the proposed new tiered public float thresholds, which would apply to both Main Board and GEM listing applicants:

Tier	Expected market value at the time of listing	Minimum percentage to be held in public hands at the time of listing
A	≤ HK$6 billion	25%

2 At Main Board Listing Rule 8.24 and Notes 2 and 3 to GEM Listing Rule 11.23

B	> HK$6 billion to ≤ HK$30 billion	Higher of: (i) the percentage that would result in the publicly held securities having an expected market value of HK$1.5 billion at the time of listing; and (ii) 15%
C	> HK$30 billion ≤ HK$70 billion	Higher of: (i) the percentage that would result in the publicly held securities having an expected market value of HK$4.5 billion at the time of listing; and (ii) 10%
D	> HK$70 billion	Higher of: (i) the percentage that would result in the publicly held securities having an expected market value of HK$7 billion at the time of listing; and (ii) 5%

The HKEX proposes that the new initial public float thresholds apply to any class of equity securities new to listing (including shares, convertible equity securities, options and warrants). However, they will not apply to:

- the initial listing of A+H issuers (and other prescribed types of issuers), which would be subject to bespoke initial public float requirements; and
- a bonus issue of a new class of securities subject to satisfaction of certain conditions.

The public float will be calculated on the basis of the class of securities in issue on listing (excluding treasury shares but including the securities issued on listing). Shares to be issued after listing (e.g. on exercise of an over-allotment option or under a share scheme) will not be included. Issuers will be required to disclose the applicable initial public float threshold in their listing documents.

Feedback sought by the HKEX on ongoing public float requirements

The HKEX Listing Rules currently require issuers to maintain the same public float percentage as at the time of listing, irrespective of changes in their market capitalisation. The HKEX Consultation Paper notes that some international stock exchanges have ongoing public float requirements that are less stringent than those applicable at the initial listing stage. Other issues include that:

- the current requirements may prevent issuers from conducting certain transactions, such as share buy-backs, if they would breach the HKEX Listing Rules by causing the public float to drop below 25%, even if the transactions could benefit the issuer and its shareholders;
- a public float shortfall can occur due to an independent third party acquiring securities and becoming a substantial shareholder who is excluded from the definition of "the public" as a result;
- issuers that breach the public float requirement are required to take steps to re-comply. However, this can be difficult and expensive. Typically, the options are for issuers to issue new shares to independent third parties or for core connected persons to sell some of their shares. However, this may not be in the best interests of the issuer and its shareholders or the core connected persons, particularly if market conditions are poor as they may be forced to issue or sell at a discounted price; and

- if trading in the issuer's securities has been suspended, it will be difficult and expensive for core connected persons to sell as sales would have to be conducted off market and with no benchmark market price.

Where an issuer fails to maintain sufficient public float, the HKEX can suspend or cancel its listing. It can also cancel the listing of any securities that have been suspended from trading for a continuous period of 18 months (GEM: 12 months). The HKEX Consultation Paper notes that no alternative trading platform is available in Hong Kong for delisted securities which means that cancellation of listing deprives shareholders of the opportunity to exit the delisted issuer.

The HKEX is seeking views on:

- the appropriate ongoing public float requirements for issuers subject to the proposed initial public float tiers and A+H issuers (and other prescribed types of issuers);

- whether issuers should be allowed to maintain a lower public float level, after listing, than that required at listing; and

- whether the HKEX's existing approach of suspending trading of issuers with public float 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) should be retained.

The HKEX would conduct a further consultation on the detailed ongoing public float proposals after reviewing the feedback on its proposed changes to the initial public float requirements. Changes to both initial and ongoing public float requirements would be implemented together only after the conclusion of that subsequent consultation.

The HKEX proposes to apply ongoing public float requirements only to listed shares, and not to convertible securities, options, warrants or similar rights.

Feedback sought by the HKEX on potential OTC market

The HKEX is also requesting views on whether an OTC market should be established in Hong Kong. In particular, it is asking for feedback on: the potential benefits and risks of establishing an OTC market; the functions that an OTC market should serve; and whether an OTC market should be open to retail investors.

HKEX's proposed changes to ongoing public float disclosures

Currently, listed issuers are required to state in their annual reports that they comply with the public float requirement. While the HKEX Listing Rules do not require issuers to state the actual percentage of publicly held shares, it is a recommended best practice under the Corporate Governance Code that issuers should disclose this information in their corporate governance reports which are published as part of their annual reports. According to the HKEX Consultation Paper, most issuers only confirm compliance with the public float requirement and do not disclose the actual number or percentage of publicly held shares.

The HKEX is proposing to require listed issuers to disclose in their annual reports:

(i) the percentage of the class of shares listed on the HKEX3[3] (excluding treasury shares) that are held by the public at the end of the financial year;

(ii) the composition of ownership of the relevant class of HKEX-listed shares at the end of the financial year, including:

(a) shares held by the following categories of shareholders who are not members of the public:

- substantial shareholders of the listed issuer and their close associates (identified on an individually named basis);
- directors, supervisors and the chief executive of the listed issuer and their close associates (identified on an individually named basis); and
- other persons excluded from the definition of "public" including: (a) directors, chief executives and chief executives of the listed issuer's subsidiaries and their close associates; and (b)

3 In the case of PRC issuers, the reference to the class of shares listed on the Exchange will be modified to mean H shares

other persons outside the definition of the public, such as persons accustomed to taking instructions from a core connected person; and

(b) shares held by the following categories of public shareholders:

- any persons that are defined as the "public" and have disclosed their interests pursuant to Part XV of the Securities and Future Ordinance (identified on an individually named basis);
- an independent trustee holding granted but unvested shares of a share scheme on behalf of the independent scheme participants; and
- other members of the public.

Listed companies would be required to make this disclosure based on information that is publicly available and within the knowledge of directors in preparing the annual report. They will also be required to make reasonable efforts to determine their actual public float for the purpose of making the required disclosure. The HKEX suggests that they could, for example, require their core connected persons and other shareholders they have identified as non-public shareholders, to notify them of their shareholdings and subsequent changes to them.

Subject to the outcome of the proposal, the recommended best practice to disclose the actual percentage of publicly held shares will be repealed.

Proposed initial free float requirement for HKEX listing applicants

The HKEX Consultation Paper proposes that a portion of a new listing applicant's publicly held shares must not be subject to any restrictions on disposal at the time of listing. This initial free float (i.e. the publicly held shares with no restrictions on disposal) would be required to: (i) represent at least 10% of the number of shares of the class to be listed and have an expected market value of at least HK$50 million; or (ii) have an expected market value of at least HK$600 million at the time of listing.

In the case of new applicant PRC issuers that have no other listed shares, the listing applicant's publicly held H shares that are free from restrictions on disposal would be required to meet the requirements under (i) and (ii) above.

New applicant PRC issuers that have other listed shares apart from the H shares would be required to have publicly held H shares free from restrictions on disposal representing at least 10% of the total number of H shares.

Only shares issued at the time of listing (excluding treasury shares) will be used for the purpose of calculating the free float. Shares that are held by an independent trustee under a share scheme will not be counted towards the proposed initial free float requirement.

The proposed free float requirement would only apply to listings of shares. It would not apply to listings of convertible securities, options and warrants.

Requirements for A+H issuers and other prescribed types of issuer

Under the current HKEX Listing Rules, listing applicants with other classes of shares listed on overseas exchanges must list at least 15% of the total number of their issued shares having an expected market capitalisation of at least HK$125 million, or HK$45 million if the listing is on GEM. This requirement is most relevant to PRC listing applicants that have listed A shares at the time they list H shares on the HKEX (**A+H listing applicants**).

The HKEX has apparently received comments that the 15% threshold is too high for listing applicants with very high market capitalisations, particularly A+H listing applicants, because it requires them to make extremely large offers. The HKEX is therefore proposing to revise the current requirement so that:

(i) PRC listing applicants with other listed shares (such as A+H listing applicants) will need to list H shares that:

- represent at least 10% of the total number of shares in the class to which the H shares belong (excluding treasury shares); or

- have an expected market value of at least HK$3 billion at listing;

(ii) Other listing applicants with other share class(es) listed overseas, must list shares of the class to be listed on the HKEX that:

- 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 listing.

The HKEX is also proposing that the minimum initial public float thresholds for A+H listing applicants and other listing applicants with other classes of shares listed on overseas exchanges will be the same as the thresholds set out above.

Part II: Proposed changes to HKEX's IPO Offering Mechanism

Proposed new staggered lock-up requirements for Cornerstone Investors

The HKEX Consultation Paper highlighted that the existing requirement prohibiting cornerstone investors from selling their IPO shares for at least six months post-listing may dissuade some potential investors from participating as cornerstone investors. This is because some institutional investors are not permitted to hold illiquid investments, while others prefers a flexible investment strategy. Another concern is that the share price of a company that lists with a significant cornerstone placing tranche can experience volatility once the six-month lock-up period ends, as the market often expects cornerstone investors to sell their shares immediately after the lock-up expires.

The HKEX is consulting on two options:

Option A: Retaining the existing six-month lock-up requirement; or

Option B: Implementing a staggered lock-up arrangement under which:

(i) all securities placed with cornerstone investors would be subject to a three-month lock-up period from the listing date;

(ii) 50% of IPO securities placed with cornerstone investors would be subject to a second three-month lock-up requirement starting on the date the first lock-up period expires.

Introducing a "ring-fencing" mechanism for the bookbuilding placing tranche on HKEX IPOs

The HKEX proposes that at least 50% of the total number of shares initially offered in an IPO be allocated to investors in the bookbuilding placing tranche. This measure aims to ensure that a significant portion of the IPO shares is allocated to the placing tranche, which the HKEX believes will enhance the price discovery process. The HKEX also proposes to remove the Main Board Listing Rule requirements for at least three shareholders for each HK$1 million placed and a minimum of 100 shareholders in the IPO placing tranche.

This proposal will not apply to the initial listing of Specialist Technology Companies under Chapter 18C of the Listing Rules, as the HKEX considers that reaching a consensus on their valuation is more challenging than for companies in traditional industries. Specialist Technology Companies will therefore remain subject to the more stringent requirement of Listing Rule 18C.08, which requires at least 50% of the total number of shares offered in their IPO to be taken up by independent price setting investors in the placing tranche.

HKEX's proposed changes to the allocation of the public subscription tranche

The HKEX is proposing to replace the existing requirement for the allocation of offer shares to the public subscription tranche with a requirement for listing applicants to either:

- initially allocate 5% of their offer shares to the public subscription tranche, subject to a clawback mechanism of either 10% or 20% depending on demand (as compared to the current requirement for a clawback of up to 50%) (**Mechanism A**); or
- initially allocate between 10% and 50% of the offer shares to the public subscription tranche, with no clawback mechanism (**Mechanism B**).

Applicants using Mechanism A would not be allowed to adopt an offering mechanism that deviates from the prescribed percentage initial allocation and the minimum thresholds triggering the clawback, unless the HKEX grants a waiver. Specialist Technology Company listing applicants would only be able to adopt Mechanism A.

HKEX's proposed changes to the restrictions on reallocation and PO over-allocation

The table below sets out the current restrictions on the reallocation of offer shares from the placing tranche to the public subscription tranche (**Reallocation**) and on the over-allocation of offer shares to the public subscription tranche (**PO Over-allocation**). The aim of these restrictions is to reduce the risk of investors in the public subscription tranche being "stuffed" with shares at a price that is unattractive to participants in the placing tranche.

<table>
<tr><td colspan="2" rowspan="2"></td><th colspan="3">Public Subscription Tranche</th></tr>
<tr><td>Undersubscribed</td><td>Fully subscribed or oversubscribed by < 15 times</td><td>Oversubscribed by ≥ 15 times</td></tr>
<tr><th rowspan="2">Placing Tranche</th><td>Undersubscribed</td><td>Underwriters must take up the shortfall</td><td colspan="2">Restrictions on Reallocation and/or PO Over-allocation</td></tr>
<tr><td>Fully or oversubscribed</td><td>No Reallocation or PO Over-allocation**</td><td>Restrictions on Reallocation and/or PO Over-allocation</td><td>Clawback mechanism</td></tr>
</table>

** If there is insufficient demand in the public subscription tranche to take up the initial allocation, offers shares can be reallocated from the public subscription tranche to the placing tranche.

Under Chapter 4.14 of the Guide for New Listing Applicants, the current restrictions on Reallocation and PO Over-allocation are that:

(i) the maximum number of shares allowed under the public subscription tranche after Reallocation and/or PO Over-allocation (the "**Allocation Cap**") must be the lower of: (a) double the initial allocation to the public subscription tranche; or (b) 30% of the total offering (before the over-allocation) (the **Maximum Allocation Cap Percentage Threshold**); and

(ii) the offer price must be the lower of: (a) the indicative offer price or bottom of the offer price range; and (b) (if adopted) the downward adjusted final offer price under the existing pricing flexibility mechanism, which allows listing applicants to reduce the offer price by not more than 10% below the indicative offer price or offer price range stated in the prospectus, if they meet certain conditions.

The HKEX proposes to retain the Allocation Cap, but proposes to make changes to the restrictions on Reallocation and PO Over-allocation. If the proposals relating to the initial allocation to the public subscription tranche are adopted, the HKEX proposes consequential amendments to the triggering conditions for the application of the restrictions on Reallocation and/or PO Over-allocation. It also proposes to lower the Maximum Allocation Cap threshold of the Allocation Cap from 30% to 15%. Consequently, under the proposed revised Allocation Cap, the maximum number of shares allowed under the public subscription tranche will be the lesser of: (a) double the initial allocation to the public subscription tranche; and (b) 15% of the total offering before over-allocation.

Part III: HKEX's proposed changes to the Pricing Flexibility Mechanism

Listing applicants are allowed to set an offer price below the indicative offer price or offer price range stated in the prospectus if they meet the following conditions:

(a) Price reduction limits:

   (i) If an indicative offer price is adopted, the final offer price must not be lower than 10% below the indicative offer price; and

    (ii) If an offer price range is adopted, the top of the offer price range must not be more than 30% above the bottom of the price range, and the final offer price must not be lower than 10% below the bottom of that range.

(b) Prospectus disclosure requirements:

    (i) A prominent statement of the possibility of downward adjustment must be included in the prospectus; and

    (ii) The potential impact of a downward adjustment must be disclosed.

An upward adjustment of the indicative offer price or the top of the offer price range currently requires listing applicants to cancel their IPO and relaunch it with revised pricing in a new or supplemental prospectus, which incurs additional time and costs.

The HKEX proposes to expand the above mechanism to allow listing applicants to adjust the final offer price both upward and downward after the prospectus has been issued. Issuers will be allowed to adjust the final offer price by a maximum of 10% above and below the indicative offer price or the top or bottom of the offer price range, respectively.

The HKEX is also seeking views on whether to retain the current upper limit on the top of the initial initial offer price range at 30% above the bottom of the range or reduce it to 20% above the bottom of the range.

Listing applicants that choose to allow the indicative offer price or price range to be adjusted upwards would be subject to similar prospectus disclosure requirements as currently apply to downward adjustment.

The proposals also include an “opt-in” option for public offer subscribers in the event that the listing applicant implements any pricing adjustment. They would be required to indicate in their application forms whether they want to subscribe for shares if the final offer price is adjusted upward or downward.

Part IV: Other HKEX Listing Rules Amendments

The HKEX Consultation Paper also sets out various proposals to make minor HKEX Listing Rule amendments which improve clarity, codify existing practices, represent consequential changes required by the changes proposed in the Consultation Paper and update outdated provisions.

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