



Hong Kong

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SFC PUBLISHES STATEMENT ON RECENT GEM LISTING APPLICATIONS AND THE REQUIREMENT FOR AN OPEN MARKET

Introduction

On 13 March 2017, the Securities and Futures Commission (the **SFC**) issued a “Statement on recent GEM listing applicants” (the **Statement**).¹ This follows the regulators’ elaboration on the requirements for IPOs on the Growth Enterprise Market (**GEM**) which are conducted by way of placing only aimed at reducing the price volatility of GEM stocks. The regulators’ guidance was set out in a **Joint Statement**² by the SFC and the Stock Exchange of Hong Kong Limited (**Exchange**)(the **Joint Statement**) and the **SFC’s Guideline to Sponsors, Underwriters and Placing Agents Involved in the Listing and Placing of GEM Stocks**³ (the **Guideline**) both published in January 2017. For further information on the Joint Statement and Guideline, please see our **February newsletter**⁴. The SFC has published the Statement as an update and to provide further guidance on its regulatory approach.

The Statement reminds GEM listing applicants seeking to list by way of placing only of their obligation to ensure that conditions exist for an open market to develop at the time of listing. GEM Listing Rule 11.23 requires an open market in the securities for which listing is sought. The SFC notes that the number of placees is not the sole factor that will be taken into account in determining whether conditions for an open market exist. The Statement also reminds placing agents that they are generally expected to notify all active clients of each placing opportunity.

The SFC issued the Statement against a backdrop of SFC concerns regarding extreme volatility in share prices of companies listed on GEM by way of placing only. In February 2017, following a 542% surge in the share price of GME Group Holdings Limited (**GME**) on the day of its listing, the SFC suspended GME from trading due to concerns regarding the existence of an open market in the shares. The SFC has since permitted dealings in GME’s shares to resume and the resumption took effect on 28 March 2017. The applications by four other companies to list on GEM by way of placing have lapsed since the issue of the Joint Statement and Guideline in January. Further details of these listing applications are set out below.

SFC Statement on Recent GEM Listing Applicants

Background

Of the 45 companies which listed on GEM in 2016, 36 listed by way of placing only, and nine included a public offer tranche. The average first day share price change (as compared to the

- 1 SFC. “Statement on recent GEM listing applicants”. 13.3.2017. <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=17PR31>.
- 2 SFC/HKEx. “Joint Statement Regarding the Price Volatility of GEM Stocks”. 20.1.2017. <http://www.hkex.com.hk/eng/newsconsul/hkexnews/2017/Documents/1701203news.pdf>
- 3 SFC Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM Stocks. 20.1.2017. <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openAppendix?refNo=17EC7&appendix=0>.
- 4 Charltons. “SFC and SEHK Impose New Requirements for Listing Applicants, Sponsors, Underwriters and Placing Agents of GEM IPOs”. February 2016. <https://www.charltonslaw.com/sfc-and-sehk-impose-new-requirements-for-listing-applicants-sponsors-underwriters-and-placing-agents-of-gem-ipos>

offer price) for GEM IPOs listed by way of placing only was an increase of 656%, with the company with the highest first day change increasing by 2005%. 30 placing-only listings saw a share price increase of 100% or more on their trading debut, of which nine experienced a price drop of over 90% and another 10 experienced price falls of between 50% and 90%, from their first day of closing to 31 January 2017. The shareholdings of the top 25 placees of the placing-only GEM listings ranged from 70% to 99.6% of the total number of placing shares. The number of placees of placing-only listings ranged from 107 to 578.

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

These statistics suggest that having a public offer tranche is more likely to achieve a shareholder base which ensures a fair and orderly market.

Five GEM stocks have listed since the issue of the Guideline and the Joint Statement on 20 January 2017. Two companies included a public offer tranche and one was a pure public offering. The average price change for the GEM stocks at the close of the first day of trading was an increase of 4.2%, not taking into account the price change of one company which was suspended from trading.

SFC's Approach to GEM Listing Applications

According to the Statement, the SFC or the Exchange may make enquiries before dealings in the shares commence if there are regulatory concerns about the listing application. The SFC can object to a listing under section 6(2) of the Securities and Futures (Stock Market Listing) Rules (Cap 571V) (**SMLR**) in specified circumstances, including 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.

Following the issue of the Guidance and the Joint Statement, four listing applicants delayed their listing plans. The SFC had concerns regarding each of these applicants' compliance with the open market requirement, and made enquiries regarding compliance with that requirement as well as their placing agents' compliance with the Guideline. The SFC's enquiries concentrated primarily on the overall strategy and allocation basis resulting in the high shareholding concentration, as well as the "know your client" procedures conducted by the placing

agents. The SFC's enquiries were made after potential "red flags" had been identified from the placees' lists submitted in support of their listing applications, e.g. multiple groups of placees sharing the same addresses and establishment of fund source.

In light of the price volatility seen for GEM IPO placings in 2016, the Statement reminds listing applicants seeking to list by way of placing only 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 possibility that the SFC could exercise its power of suspension under section 8 of the SMLR if it observes irregularities in the trading of shares after listing.

The SFC issued a section 8(1) SMLR notice directing the Exchange to suspend all dealings in the shares of a listing applicant which proceeded to trading. It appeared to the SFC that an open market may not have existed and that a suspension was necessary or expedient so as to maintain 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.

Historically, the SFC has directed the Exchange to suspend shares after identifying potential material breaches of the Securities and Futures Ordinance (Cap 571) during the course of an investigation. Other grounds for suspension include the absence of an open market, unusual trading patterns suggesting market manipulation and evidence of false or misleading disclosures.

The aim of a suspension is to protect a wide range of market participants, including potential investors by preventing them from investing on an uninformed basis. The SFC will also take into account the effect of suspension on the existing shareholders. Companies may make representations to the SFC following the direction of a suspension, and the SFC may consequently maintain or lift the suspension, or delist the company.

Open Market and Approaching All Active Clients

GEM Listing Rule 11.23 requires an open market in the securities for which listing is sought, and the Statement reiterates that it is the issuer's responsibility to ensure an open market, and the sponsor's responsibility to, inter alia, advise and guide the issuer as to that responsibility.

The number of placees is not the sole factor that will be taken into consideration when determining whether a GEM listing applicant's shareholdings are overly concentrated such that the conditions for an open market do not exist. Having a public offer tranche is more likely to achieve a shareholder base which will ensure a fair and orderly market.

The placing process is also important in achieving conditions for an open market. The Statement reminds placing agents that they are generally expected to notify all of their active clients of each placing opportunity. The SFC notes that some placing agents have purchased shares in the market for their existing clients soon after the listing at a price substantially higher than the IPO price, which suggests that these placing agents may not have approached all of their active clients who would be interested in purchasing the IPO shares.

The SFC also reminds all placing agents that they need to have a robust marketing and placing strategy and an allocation basis which aim to achieve an open market in the offered securities, including an adequate spread of shareholders.

The SFC expects appropriate policies and procedures to be 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. These procedures should include a marketing programme directed to a wide range of clients.

Suspension of GME Following Sharp Price Rise on Debut

A 542% surge in the share price of GME on its debut on the GEM resulted in its suspension from trading just 4 hours after commencement of trading in its shares on 22 February 2017. Following the sharp rise in the company's share price in the morning trading session on the day of listing, the SFC exercised its power under Rule 8(1) of the SMLR to direct the Exchange to suspend dealings in GME's shares from 1.00 p.m.

Rule 8(1) of the SMLR gives the SFC broad powers to order the Exchange to suspend dealings in listed company shares in a range of circumstances, including where the SFC considers the company's listing document to be false, misleading or incomplete in a material respect, or that the suspension is necessary to maintain an orderly and fair market in its shares or to protect investors or the public interest.

The SFC's stated reason for GME's suspension was that it doubted the existence of an open market in the trading of the shares, given the significant rise in the share price relative to its placing price of HK\$0.54 per share. The volume of shares traded during the morning session was HK\$69.5 million. GME's announcement confirmed that it was not aware of the reason for the movement in its share price, or of any information that would need to be announced to avoid a false market in the company's securities.

GME listed by way of placing on GEM, the type of listing the target of the SFC Guideline issued in January. The Guideline contains a reminder of the requirement of GEM Rule 11.23 that there must be an open market in the shares for which listing is sought. It also stressed that the minimum of 100 shareholders specified by GEM Rule 11.23(b) is only a guide as to whether there is an adequate spread of shareholders. The Guideline states that meeting the minimum requirement would not guarantee satisfaction of the Listing Rule requirement for an open market in the securities, particularly in cases where the publicly held shares are overly concentrated. In the case of GME, its announcement indicated that the placing shares were allocated to 167 placees. Trading in GME's shares resumed on 28 March 2017 following steps taken by the company to widen its shareholder base. These involved the placing of 25,000,000 placing shares previously held by the company's controlling shareholders being placed by the company's placing agents to 455 independent placees.

Lapsing of Listing Applications of Four Other Companies

Four companies have shelved their listings since the issue of the Guideline and the Joint Statement. Following enquiries by the SFC, My Heart Bodibra Group Limited, Speed Apparel Holding Limited, Hao Bai International (Cayman) Limited and XiangXing International Holding Limited announced that their applications to list on GEM by way of placing had lapsed as the conditions for each placing as set out in their prospectuses had not been fulfilled within 30 days of the date of the relevant prospectus.

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