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The Exchange's Concept Paper on Modernising Hong Kong's IPO Settlement Process

In relation to the captioned concept paper, the Hong Kong Institute of Directors (“HKIoD”) wishes to present the following views and comments.

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General comments

The present concept paper is on proposals to modernise and streamline Hong Kong’s IPO settlement process through launching a new web-based service named Fast Interface for New Issuance (“FINI”). FINI provides a new platform for initial public offerings (“IPO(s)”) market participants, advisers and regulators to interact digitally and seamlessly on the steps that comprise the end-to-end IPO settlement process.

HKIoD supports the overall proposal outlined in the concept paper.

The implementation of FINI will shorten the IPO settlement time from five business days after the pricing day (“T+5”) to one business day after the pricing day (“T+1”) and hence improve Hong Kong’s IPO market competitiveness in competing with other popular equity fundraising venues, such as New York and London, which have allowed “T+1” trading already. The shortened pricing-trading gap is particularly beneficial to issuers having a secondary listing or separate simultaneous listings.

The shortened settlement time can reduce market risk in long settlement period. During the current lengthy settlement process, investors would have to commit to purchasing the shares and be exposed to potential fluctuations in the value of their positions. A shorter settlement period helps reduce the degree of influence that the current “T+5” settlement process or other extraneous circumstances might have on the pricing of IPOs and give investors quicker access to secondary market. Retail investors also bear a lower cost for their subscription due to a reduced interest payment on margin loan. Cutting the settlement time also reduces the risks and potential manipulations associated with grey market activities, especially when the market is volatile.

We noted that the Exchange proposes to substitute the current time-consuming “pre-fund & refund” practice, under which the intermediaries participating in the public offer tranche will commit and transfer full IPO subscription funds to the issuer’s receiving bank upfront and be subsequently refunded based on the ultimate allotment of shares, by a “fund locking” confirmation mechanism that is successfully used in certain other popular IPO markets, including India (National Stock Exchange) and the Nordics (Nasdaq OMX). Under the “fund locking” confirmation mechanism, at least 10% of the subscription value must be pre-funded in cash by the intermediary, while the remainder may be supported by either cash or committed credit facilities.

HKIoD agrees with the Exchange that the “fund locking” confirmation mechanism can alleviate short-term liquidity issues in the current practice. Furthermore, as retail brokers and

share registrars must ensure that their clients have adequate cash or credit to be able to support the settlement of their respective subscriptions in full and the arrangements between intermediaries and their end-clients remain subject to regulatory rules and their respective bilateral contracts, HKIoD believes that the “fund locking” confirmation mechanism would not massively inflate subscription orders or encourage the “apply for free” mentality.

As pointed out by the Exchange, the current IPO settlement process in Hong Kong relies heavily on manual operations and analogue interactions which may create errors and unforeseen operational risks. The proposed features and functions of FINI, especially the real-time validation against data, common data standards and duplicated or invalid subscriptions, will help to detect omissions, inconsistencies or errors and reduce the time on error-checking.

HKIoD believes that the launch of FINI could provide a scalable infrastructure to meet market growth and reinforce Hong Kong’s position as a leading listing venue.

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Feedback form questions

Subject to the general comments above, we state below our response to specific questions as set out in the feedback form of the concept paper.

Question 1: Do you support the overall proposal outlined in this Concept Paper?

HKIoD response

- We support the overall proposal on the following grounds:
 - The shortened settlement time can enhance Hong Kong’s competitive edge and reduce the risk investor exposed to during the current lengthy settlement period and the operational risk created due to manual processing.
 - It will also reduce subscription cost for retail investors due to a reduced interest payment on margin loan and reduce the risks and potential manipulations associated with grey market activities, especially when the market is volatile.

Question 2: Do you have any comments or suggestions regarding specific aspects of the proposed reform or the functionality of the proposed FINI platform?

HKIoD response

- HKIoD believes that the “fund locking” confirmation mechanism can alleviate short-term liquidity issues created in current practice, especially in high-profile IPOs with large amounts of investors’ fund involved. HKIoD believes that the “fund locking” confirmation mechanism would not massively inflate subscription orders or encourage the “apply for free” mentality as the retail brokers and share registrars would still have the obligation to ensure that their end-clients would be able to support the settlement of their respective subscriptions in full.

Question 3: Are there any other aspects of Hong Kong's IPO process that are not featured in this Concept Paper, but which you would like to see included as part of this proposed reform?

HKIoD response

- We understand that on-market book-building currently has various operational issues and may require substantive regulatory changes and the Exchange has issued two other regulatory initiatives on digitalising the IPO process. As the technologies may evolve in future, we would suggest that the Exchange revisits its position regarding on-market book-building for IPOs from time to time.

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