

# Cornerstone investors in IPOs—an Asian perspective

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## Key points

- Asian IPOs in recent years see the increased importance of cornerstone investors to minimize execution risks against the backdrop of volatile equity markets.
- This article explores the role of cornerstone investors in the context of Asian IPOs, and examines some of the key legal and regulatory considerations which may come into play in relation to cornerstone investments in the Singapore, Malaysian and Hong Kong markets.
- This article concludes that, insofar as equity markets remain volatile, cornerstone investors will continue to be critical to the success of IPOs.

## 1. Introduction

The global equities market experienced a bull run in the years leading up to the Global Financial Crisis. Since the third quarter of 2007, however, equity markets globally have been subject to substantial volatility. Against this backdrop, it has understandably been challenging to launch IPOs, and investment banks mandated on IPOs have had to manage the IPO process even more carefully and strategically than usual in order to minimize execution risks. While cornerstone investors are not new in the context of Asian IPOs, they have assumed increased focus given the market volatility.

Cornerstone investors are comparatively less common outside of Asian IPOs, though there are signs of the cornerstone process taking root in European markets, with issuers and investment banks drawing on Asian equity markets practices in an attempt to de-risk the IPO process.

This article seeks to explore the role of cornerstone investors in the context of Asian IPOs, and considers some of the key legal and regulatory considerations which may come into play in relation to cornerstone investments in the Singapore, Malaysian and Hong Kong markets.

## 2. Assessing the role of cornerstone investors in Asian IPOs

In assessing the role of cornerstone investors in Asian IPOs, this article starts by examining what is typically understood by the term ‘cornerstone investor’, and distinguishing cornerstone investors from other categories of key investors. This is

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followed by an assessment of the benefits of cornerstone investors, and a survey of the incidence of cornerstone investors by reference to statistics from the Singapore, Malaysian and Hong Kong markets.

### Meaning of ‘cornerstone investors’

In the context of IPOs, the term ‘cornerstone investors’ is generally understood to refer to that class of investors who commit in advance to invest a fixed amount of money, or for a fixed number of shares, in an IPO. Their commitment is typically sought and given just prior to the management roadshow and book-building exercise, on the basis of a price range indicated by the investment banks. The allocation of shares to such cornerstone investors is guaranteed in the cornerstone agreement executed by each cornerstone investor—where the commitment is expressed as a fixed amount of money rather than a fixed number of shares, the actual number of shares to be received is calculated at the point when the final price is determined following book-building.

Cornerstone investors are not to be confused with other categories of investors who might likewise make significant investments in a company. In particular, unlike pre-IPO investors, cornerstone investors feature late in a company’s history, are generally financially motivated and typically subscribe at the IPO price. Pre-IPO investors by contrast have more varied motivations.<sup>1</sup> Traditionally, pre-IPO investments were made at an early stage and individually negotiated, with expectations of involvement in strategic and management decisions via board representation. Increasingly however, pre-IPO private placements are being conducted on common terms for a group of investors whose primary objective is to benefit financially from the anticipated IPO by disposing of their shares upon expiry of any applicable lock-up period. Regardless of the method by which pre-IPO investors participate (whether via shares or more commonly in Asia nowadays, via pre-IPO convertible bonds), such investors usually seek a discount to the IPO price.<sup>2</sup>

Cornerstone investors should also be distinguished from ‘anchor investors’. While likewise investing in large amounts, anchor investors place their orders during the book-building process, and their allocations are not guaranteed. Anchor investors are typically not disclosed in the prospectus and not subject to lock-ups. In the recent IPO for Galaxy Securities, some commentators have suggested that the comparatively small cornerstone tranche could have been due to potential cornerstone investors opting to participate as anchor investors instead, in order to have the ability to place a price limit on their orders rather than committing to buying shares throughout the price range.<sup>3</sup>

1 W Pearce and H Smith, ‘Pre-IPO Financing and Cornerstone Investors: Asian Influences in European Equity Offerings’ (September 2012) *Butterworths Journal of International Banking and Financial Law* 506–507.

2 For a Hong Kong listed company, it should be noted, however, that HKEx issued guidance in October 2012 via Guidance Letter HKEx-GL44-12, which provides expressly that the conversion price for pre-IPO convertible instruments should be at a fixed dollar amount or at the IPO price. Where the conversion price is based on a guaranteed discount to IPO price or linked to market capitalization, this is deemed to give rise to concerns that the pre-IPO investor does not bear the same investment risk as public investors.

3 A Jönsson, ‘Galaxy Securities Enlists 21 Banks to Raise Up to \$1.37 Billion’ *FinanceAsia* (7 May 2013).

The pool of cornerstone investors in Asian IPOs varies from deal to deal, and could comprise a mixture of sovereign wealth funds or state-linked investment vehicles (such as Temasek Holdings and GIC from Singapore, Malaysia's Khazanah Nasional, CIC from the PRC, Abu Dhabi Investment Authority and Qatar Investment Authority), asset managers and other institutional investors, and large hedge funds. Local tycoons (either in their personal capacity, through their investment holding companies or companies in which they have a controlling stake) also feature prominently, especially in Hong Kong IPOs—with names such as Li Ka Shing (and Cheung Kong (Holdings) Limited which is controlled by him), Lee Shau Kee (and his majority-owned property conglomerate Henderson Land Development), the Kwok brothers (and Sun Hung Kai Properties Limited which is controlled by them), and Kuok Hock Nien (who controls Nan Fung Group Limited) all having appeared on the list of cornerstone investors.

More interestingly, private equity firms (such as Baring Private Equity Asia, D.E. Shaw, PAG and Sequoia Capital) have also been seen getting in on the action. Their participation as cornerstone investors can be sensitive, as it raises the question of whether private equity firms should really be charging management fees and a potential carry for making public market investments. Investors in private equity funds generally expect their fund managers to conduct detailed due diligence, seek governance rights and control (or at least substantially influence) over their investee companies—none of which is usually possible via a cornerstone investment. It may emerge, however, that private equity firms' participation as cornerstone investors would prove to be a temporary rather than sustained phenomenon, coinciding with compelling valuations in depressed public equities markets and the desire to deploy large amounts of capital quickly as funds approach their final close while still holding onto significant dry powder due to the lack of attractive private equity opportunities in recent years.<sup>4</sup>

### Benefits of cornerstone investors

The benefits of having cornerstone participation in an IPO would seem apparent. Most commentators cite the signalling and halo effects of a cornerstone tranche—particularly vis-à-vis retail investors, who often lack the ability to analyse the prospectus or otherwise assess the investment story and any associated downside risks. The thesis is that having household names as cornerstone investors in an offering would significantly raise the profile of a transaction, demonstrate interest in the offering to the wider market and by lending credibility and stimulating demand, thereby increase the chances of favourable pricing and of the transaction successfully closing.

In a weak equity market, the reality is that the cornerstone tranche is not just a marketing gimmick to attract retail orders, but actually critical to whether the IPO succeeds at all. By guaranteeing that a proportion of the deal will be sold, the investment banks have less to sell, which clearly assists the success rate of an IPO (especially one which is sizeable) in challenging market conditions. This has led to cornerstone investors

4 S Birkwood, 'Cornerstone Investors: Public Market Props' *Asian Venture Capital Journal* (18 July 2012).

featuring with increasing regularity in Asian IPOs in recent years, and also engendered a significant increase in the size of the cornerstone tranche when it did feature.

Conversely, the inability to attract cornerstone investors may have proved fatal to a number of deals in the current environment. A high profile example is the ill-fated Graff Diamonds IPO on the Hong Kong market in May 2012, which was pulled a day before its proposed US\$1 billion IPO was due to price. Undoubtedly, market conditions were unfavourable and the investment story was perhaps not sufficiently compelling, but the absence of cornerstone investors certainly added to the marketing difficulties.<sup>5</sup> By contrast, the US\$3.3 billion IPO of Felda in Malaysia, marketed around the same time, had 12 cornerstone investors committing to approximately a third of the deal, resulting in the offering quickly becoming multiple times subscribed.

Such is the importance of the cornerstone tranche in the current environment that investment bankers have been quoted as saying that the ability of an investment bank to market an IPO to prospective cornerstone investors is increasingly considered critical in securing new listing mandates. This has tended to benefit the larger investment banks who are able to leverage off their broad network of clients through a combination of their equities desks, public sector groups and affiliated private banking outfits.

### Statistics from the Singapore, Malaysian and Hong Kong markets

To assess the incidence of cornerstone investors in Asian IPOs, a desktop survey was conducted of the IPO prospectuses publicly available from the websites of the Singapore Exchange Limited (SGX), Bursa Malaysia Securities Berhad (Bursa Securities) and Hong Kong Exchanges and Clearing Limited (HKEx) pertaining to IPOs launched in these markets in 2012, with the objective of highlighting the profile of cornerstone investors active in these markets, providing a sense of the quantum of their investments and the restrictions (if any) imposed thereon, and ascertaining the effect of their involvement on the retail tranche and the overall offering.

The results of this desktop survey are set out in Appendix 1 to this article.

Broadly analysed, cornerstone tranches were prevalent in the larger IPOs launched during 2012 in these markets. In the Singapore market, there were five IPOs<sup>6</sup> where the total amount raised at IPO (inclusive of the cornerstone tranche) was in excess of S\$100 million. Of these, four involved a cornerstone tranche. In Malaysia, three out of the five IPOs where the amount raised at IPO was in excess of RM200 million involved a cornerstone tranche. This trend was even more apparent in Hong Kong, where out of the 20 IPOs where the amount raised at IPO was in excess of HK\$500 million, 16 involved a cornerstone tranche.<sup>7</sup>

5 P Espinasse, 'The Graff Diamonds IPO's Seven Sins' *IPO: A Global Guide* (11 June 2012).

6 Excluding for this purpose the IPO of IHH Healthcare Berhad, which had a primary listing in Malaysia and a secondary listing in Singapore.

7 Data in respect of Hong Kong IPOs is limited to IPOs on the Main Board—data in relation to IPOs on the Growth Enterprise Market have not been included for the purposes of this article.

The size of the cornerstone tranche (expressed as a percentage of the total offering of shares comprised in the public tranche, placement tranche and cornerstone tranche) ranged from approximately 6 to 53 per cent in the Singapore market, approximately 28 to 62 per cent in the Malaysian market, and approximately 15 to 61 per cent in the Hong Kong market (with the majority in the range of 30 to 60 per cent).

From this data, it would appear that concerns about rendering the counter illiquid or having an insufficiently diverse shareholder base have been overtaken by concerns regarding the ability to complete the IPO at all.

However, no immediate conclusion can be drawn from the data as regards the traditional thesis that cornerstone investors help to stimulate demand from other investors (in particular retail investors), as subscription levels for the retail tranches of the IPOs in these markets in 2012 do not show any direct correlation to the existence or size of the cornerstone tranche.

### **3. Legal and regulatory considerations relating to cornerstone investors**

The importance and prevalence of cornerstone investors in Asian IPOs mean that the process of approaching cornerstone investors needs to be carefully managed. Similarly, regulators are focused on preventing any potential abuse of the cornerstone process.

The ensuing paragraphs begin by analysing the cornerstone process (as this raises some common issues across jurisdictions) and go on to highlight some of the key legal and regulatory considerations pertaining to cornerstone investors in the Singapore, Malaysian and Hong Kong markets.

#### **The cornerstone process—controlling information flows**

The cornerstone process is conducted in a similar manner in Singapore and Hong Kong IPOs. Prospective cornerstone investors are usually approached a few weeks prior to the commencement of the management roadshow and are required to sign confidentiality agreements before being provided with drafts of the prospectus which will be some time before the prospectus becomes public. In Hong Kong IPOs (though not in Singapore IPOs), cornerstone investors are sometimes also given the benefit of separate management meetings. However, cornerstone investors are not provided with any material information beyond that to be contained in the final prospectus. In other words, the only preference that cornerstone investors in Singapore and Hong Kong IPOs have over other investors as regards information flows relates to timing rather than content. Failure to ensure this is the case threatens to call into question the integrity of the prospectus as a whole.

The cornerstone process in a Malaysian IPO differs in some respects from the typical cornerstone process adopted in Singapore and Hong Kong IPOs. In Malaysia, prospective cornerstone investors are usually approached during the period pending the approval of the Malaysian Securities Commission (MSC) of the proposed IPOs and are similarly required to sign confidentiality agreements. In certain IPOs, a preliminary prospectus

(a document designed to assist an issuer in setting a price in respect of a proposed IPO or to determine the final contents of a prospectus) is provided to the prospective cornerstone investors, subject to certain conditions being met. Prospective cornerstone investors are not given the benefit of separate management due diligence sessions. For IPOs of companies (but not collective investment schemes), a redacted draft prospectus is usually uploaded on the website of the MSC shortly after the application for the IPO is submitted to the MSC. As such, cornerstone investors in a Malaysian IPO generally have no preference over other investors as regards information flow.

In the case of spin-offs or business trust listings where the parent or sponsor is a listed entity, there may be additional concerns in Singapore and Hong Kong IPOs with regard to selective disclosure of information.<sup>8</sup> In such cases, the starting point would typically be to include a trading standstill provision in the confidentiality agreement to counter any potential insider trading issues. This could cause difficulty for some prospective cornerstone investors especially where the stock is actively traded or the prospective cornerstone investors are already holders of the stock. In Hong Kong IPOs (though not in Singapore IPOs), the approach in certain cases has been to provide a redacted version of the draft prospectus or alternatively for the listed parent or sponsor to make a suitable public announcement, in order to 'cleanse' any potential material price sensitive information.

Cornerstone agreements must be signed at the latest prior to the printing of the red herring prospectus (so that information on the cornerstone tranche can be provided (as intended) during marketing of the deal to institutional investors), though depending on the expectations (if any) of regulators in the relevant jurisdiction, these could be signed earlier.

## Singapore

The Monetary Authority of Singapore (MAS) is the key regulator in a Singapore IPO and all prospectuses relating to public offers of securities in Singapore have to be registered with the MAS prior to commencement of the offering.

In a Singapore IPO, cornerstone investors are technically considered to be outside the scope of the IPO offering (the cornerstone tranche being treated as a separate concurrent offering)—this is in contrast to the general position in Hong Kong and Malaysia, where the cornerstone tranche is deemed to be a subset of the placement tranche.

<sup>8</sup> Where the parent in a spin-off listing or the sponsor in a business trust listing is listed on the Main Board of the SGX, it would be relevant to consider Appendix 7.1 of the Listing Manual, which provides *inter alia*, that 'under no circumstances should disclosure of material information be made on an individual or selective basis . . . unless such information has previously been fully disclosed and disseminated to the public.' Nonetheless, the SGX recognizes that there may be limited instances where selective disclosure is necessary (eg in the pursuit of the issuer's business or corporate objective). In these circumstances, disclosure should be made on a need-to-know basis and subject to appropriate confidentiality restraints. Similar rules on the disclosure of price sensitive information apply in Hong Kong. The foregoing is not an issue in Malaysian IPOs as cornerstone investors are approached after the listing application has been submitted to, but pending approval by, the MSC, and the listed parent would already have made the announcement on the proposed spin-off and listing of a subsidiary or business on the day of the submission of the listing application to the MSC.



### ***Approaching cornerstone investors in Singapore***

In approaching prospective cornerstone investors, it is common to rely on the exemption from the prospectus regime provided in Sections 274 or 275 of the Securities and Futures Act, Chapter 289 of Singapore (SFA), as the nature of cornerstone investors is such that they would typically fall within the ambit of ‘institutional investors’ or ‘accredited investors’ as defined in the relevant sections. The other option, which does not require analysis of the nature of the cornerstone investor, is the ‘private placement’ exemption under Section 282B of the SFA, which allows for offers to be made to up to 50 offerees within a 12-month period without triggering the need to provide a prospectus. However, this exemption focuses on the number of ‘offers’, rather than acceptances—and so may not be feasible if marketing efforts are directed towards a large pool of prospective cornerstone investors (as is increasingly the case) and/or if the cornerstone marketing exercise has been repeated over the course of a 12-month period due to delays in the execution timetable.

Subject to compliance with the applicable selling restrictions and the public spread requirements under the SGX Listing Manual, there is generally no restriction on who can be a cornerstone investor in a Singapore IPO.

### ***Transparency—at IPO and post-listing***

The SFA provides for the general requirement that a prospectus should contain all information which investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attached to the securities as well as the assets and liabilities, profits and losses, financial position and performance and prospects of the issuer.<sup>9</sup> More specifically in relation to cornerstone investments, there is a requirement to disclose in the prospectus ‘details of the nature of such subscriptions’, as well as the ‘number’ and ‘characteristics’ of the securities to which they relate.<sup>10</sup>

Within these broad parameters, prospectuses in Singapore IPOs typically disclose the names of the cornerstone investors, a short narrative of the nature of their business, the amounts of their commitments and salient details of their commitments (such as inter-conditionality with the placement or retail tranches). Traditionally, the amounts of commitments have been provided on an individual basis, but there is now a trend towards disclosing commitments on an aggregate basis.<sup>11</sup>

It is also helpful from the perspective of ensuring transparency that cornerstone agreements are typically included in the list of material contracts available for public inspection in connection with the IPO.

On an ongoing basis post-listing however, there may be little by way of update—the interests held by cornerstone investors are usually below 5 per cent of the issued share

9 See s 243 of the SFA (in relation to offerings of shares) and s 282F of the SFA (in relation to offerings of units in a business trust).

10 See the Fifth Schedule of the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005, Part X, para 14 (in relation to offerings of shares) and the Fourth Schedule of the Securities and Futures (Offers of Investments) (Business Trusts) (No 2) Regulations 2005, Part XI, para 14 (in relation to offerings of units in a business trust).

11 See eg the IPO prospectus for IHH Healthcare Berhad.

capital of the company, with the consequence that cornerstone investors are not required to disclose acquisitions or disposals of their shares pursuant to the substantial shareholder reporting requirements.

### **Pricing, allocation and lock-ups (or lack thereof)**

Much of the current debate regarding cornerstone investors in Asian IPOs centres on the question of whether the cornerstone process is or can be consistent with the spirit of a key guiding principle of the listing rules that all holders of listed securities should be treated fairly and equitably.<sup>12</sup>

During periods of strong IPO activity when post-IPO share prices generally rise, it may be difficult to dispel the sentiment that cornerstone investors are not assuming any meaningful risk in exchange for their preferred status. Yet, a counter-argument could be made that the involvement of cornerstone investors may be precisely the reason (at least in part) for stable or even strong post-IPO share price performance. What is clear, however is that cornerstone investors do take on some level of equity risk—indeed, significant losses within a couple of months post-IPO are not unheard of.

The balance struck by regulators in regulating the cornerstone process in order to ensure a level playing field for all investors differs from jurisdiction to jurisdiction.

In Singapore, the balance appears to be a straightforward one.

The ‘preferred’ status of cornerstone investors in Singapore is limited to a guaranteed allocation of shares, which is unaffected by clawbacks. There is currently no statutory clawback mechanism in Singapore<sup>13</sup> and cornerstone investors typically fall outside contractual clawback provisions in underwriting agreements which provide full discretion to underwriters to re-allocate between the placement and public tranches in the event of over-demand in one tranche and under-demand in the other.

To date, no pricing discounts have been allowed by the regulators in Singapore.

However, unlike in Hong Kong, cornerstone investors in Singapore are not typically expected to provide lock-ups of their shares—cornerstone investors in Singapore, insofar as they are not connected to the issue manager of the IPO, do not fall within the scope of the moratorium rules imposed under the SGX Listing Manual as they subscribe at the IPO price, and contractual lock-ups are rare. Cornerstone investors in a Singapore IPO who are connected to the issue manager of the IPO are subject to a six-month moratorium on their shareholdings under the SGX Listing Manual, unless they fall within the exemption specified therein.<sup>14</sup>

12 The article by CK Low, ‘Cornerstone Investors and Initial Public Offerings on the Stock Exchange of Hong Kong’ (2009) 14 *Fordham Journal of Corporate & Financial Law* 665–669, 639, is particularly focused on this issue.

13 A public consultation paper published by the SGX in October 2012 entitled ‘Proposed Initiatives in relation to Offer Structure of Initial Public Offers’ proposes to introduce a statutory clawback mechanism to reallocate shares between the placement and public subscription tranches, but recommendations have yet to be published in response to this consultation exercise.

14 See Rule 229(5) of the SGX Listing Manual, which provides an exemption in the event that (1) the investor is a fund manager and the funds invested in the issuer are managed on behalf of independent third parties; (2) the investor and the issue manager have separate and independent management teams and decisions making structures; and (3) proper policies and procedures have been implemented to address any conflict of interest arising between the issue manager and the investor. The onus is on the issuer to consult and demonstrate to the SGX that these conditions have been met, in order for the six-month moratorium not to apply.



## Malaysia

Similar to the position in Singapore, there are few regulations relating to cornerstone investors in Malaysia. While the cornerstone tranche usually forms part of the placement tranche in a Malaysian IPO, cornerstone investments are not *per se* regulated in Malaysia.

The key regulators in a Malaysian IPO are the MSC and Bursa Securities. The MSC regulates all matters relating to securities and derivatives under the Capital Markets and Services Act 2007 (CMSA), including IPOs and is the registering authority for prospectuses of corporations (other than unlisted recreational clubs). Bursa Securities maintains the securities exchange in Malaysia and supervises listed issuers. Bursa Securities has issued the Main Market Listing Requirements and the Ace Market Listing Requirements to stipulate the requirements that need to be met by an applicant seeking admission and a listed issuer on a continuing basis.

### ***Approaching cornerstone investors in Malaysia***

Generally, an IPO proposal or scheme may not be effected, carried out or implemented without the MSC's approval. However, the CMSA provides that an agreement in connection with the subscription or purchase of securities (such as a cornerstone agreement) may be entered into prior to the MSC's approval being granted if the terms of such agreement are not binding until the fulfilment of any condition(s) set out in such agreement, including the grant of MSC approval. Accordingly, the cornerstone agreement signed by cornerstone investors would typically contain as a condition precedent the receipt of the requisite approvals from MSC.

Typically only 'accredited investors', 'high net worth entities' or 'high net worth individuals' within the ambit of Schedule 6 or 7 of the CMSA will be approached to be cornerstone investors in a Malaysian IPO.

### ***A flexible disclosure-based regime***

The main focus of the MSC as regards cornerstone investments is on disclosure of details of the cornerstone investments. The MSC does not regulate and will not interfere with the pricing of the cornerstone tranche in a Malaysian IPO. The MSC also does not impose minimum lock-up periods for cornerstone investors. Lock-up arrangements for cornerstone investors are commercial decisions to be made by the issuer and syndicate banks.

As a matter of market practice in major Malaysian IPOs, the common lock-up period used to be six months but there are signs of flexibility in this regard. In the US\$2.1 billion IPO of IHH Healthcare (involving a primary listing in Malaysia and a secondary listing in Singapore), each of the 22 cornerstone investors were subject to a six-month lock-up only in respect of that portion of their allocation in excess of 50 million shares. Similarly, in the US\$1.5 billion IPO of Astro Malaysia, cornerstone investors were only locked up for three months in respect of allocations exceeding 15 million shares. Indeed, it has been suggested that the more flexible stance towards lock-ups in Malaysia (and also in

Singapore) may be amongst the drivers for the success of these markets in attracting new listings.<sup>15</sup>

The Prospectus Guidelines issued by the MSC require certain information relating to cornerstone investors to be contained in the prospectus including the number and type of securities proposed to be issued or offered to cornerstone investors, the nature of sales or subscriptions and the number and characteristics of securities which are sold privately to cornerstone investors, and the prices applied to cornerstone investors.

Such information disclosed in the prospectus is usually limited to the identity of the cornerstone investors, details of the master cornerstone agreement which is typically entered into by cornerstone investors and any lock-up arrangements, and the amount of securities subscribed by the cornerstone investors which typically is aggregated and represented as a collective amount. The master cornerstone agreement would constitute a material contract and would be made available for public inspection in connection with the IPO.

Similar to Singapore, cornerstone investors are not subject to continuing disclosure requirements unless a cornerstone investor has an interest in 5 per cent or more of the issued share capital of the company thereby requiring the cornerstone investor to comply with the substantial shareholding reporting requirements under the Companies Act 1965.

## Hong Kong

The lead regulator of Hong Kong's securities industry is the Securities and Futures Commission (SFC), whose powers and duties are set out in the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (SFO). Some of the SFC's functions relating to listings and listed companies have been delegated to The Stock Exchange of Hong Kong Limited (SEHK), in particular the function to issue and administer the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ('Listing Rules').<sup>16</sup> Under current arrangements, the SEHK takes the leading role as far as listings and listed companies are concerned, but its supervisory authority is not exclusive and the SFC continues to exercise its investigatory and enforcement powers in relation to listing matters.

The cornerstone tranche in a Hong Kong IPO is treated as part of the placement tranche and given the requirement under the Listing Rules for an offering to be fully underwritten, the cornerstone tranche is underwritten by the underwriters as part of the placement tranche. This is in contrast to the position in Singapore and Malaysia, where there is no requirement to underwrite the cornerstone tranche.

Compared to Singapore and Malaysia, there has been more regulatory guidance in Hong Kong on cornerstone investors.

15 P Espinasse, 'Outdated Rule on Lock-ups is One Reason Why Malaysia's IPOs Outstrips Hong Kong's' *South China Morning Post* (29 October 2012).

16 HKEx is the holding company of SEHK.

***Approaching cornerstone investors in Hong Kong***

Placings to cornerstone investors in Hong Kong IPOs are generally permitted provided that: (1) the placing is at the IPO price; (2) the IPO shares are subject to a lock-up period for at least six months; (3) there are no direct or indirect benefits provided to placees (eg financial assistance) other than a guaranteed allocation; (4) each cornerstone investor is independent of the issuer and its connected persons and (5) details of the arrangements, including the identity and background of the investors, are disclosed in the listing document.

As mentioned above, a principal regulatory criterion is that cornerstone investors must not be connected persons of the issuer, and should be independent from the issuer and its directors and their associates and the existing shareholders of the issuer. Furthermore, the Placing Guidelines (in Appendix 6 to the Listing Rules) prohibit the allocation of shares to ‘connected clients’ of the underwriting syndicate (which includes all members of each underwriter’s corporate group). This means that no allocations can be made to the proprietary accounts of the underwriting banks, although allocations to fund management and private wealth management arms of the underwriters are permitted, provided that the ultimate beneficiaries are independent third parties.

Subject to these points, the participation of cornerstone investors in a Hong Kong IPO is largely a commercial decision.

***No ‘double-dipping’***

The Listing Rules provide that existing shareholders of an issuer may only subscribe for shares in an IPO if the shares are not offered to them on a ‘preferential basis’. This provision has been interpreted broadly by the SEHK, with the result that cornerstone investors and their associates are not allowed to place an order in the book-building process for shares in the international offering or otherwise obtain any additional allocation in the offering beyond their cornerstone subscriptions—so-called double-dipping.

***Enhanced prospectus disclosure and access to information***

Disclosure of the cornerstone tranche is typically contained in a separate section of the prospectus, and the disclosure is required to include the identity of each cornerstone investor, the amount invested, confirmation of the independence of the cornerstone investor, the conditions of the investment and its percentage shareholding of the issuer post-listing.

In addition, cornerstone agreements will constitute material contracts of the issuer, will be required to be disclosed as such in the prospectus, and will be required to be delivered to the Companies Registry as part of the prospectus registration process and made available for public inspection.

***Increased regulatory scrutiny of equality of treatment issues***

Compared to its counterparts in Singapore and Malaysia, the SEHK has taken a more proactive stance in policing equality of treatment issues arising from the cornerstone process.

In return for their commitments, cornerstone investors in Hong Kong are guaranteed an allocation of shares in the IPO, which allocation is unaffected by the clawback provisions of Practice Note 18<sup>17</sup> in the event of excess demand in the Hong Kong public offer. However, unlike in Singapore and Malaysia, lock-ups of cornerstone investors are required by the SEHK, as a *quid pro quo* for their preferred status. Lock-ups are expected to apply for a period of at least six months and are intended to facilitate an orderly market after the IPO by restricting the resale of shares for immediate profit. Some commentators have argued, however, that lock-ups reduce liquidity (because of the number of shares that are locked up) and create an overhang effect with prices coming under pressure as the market anticipates sell-downs around the time of expiry of the relevant lock-up periods.

The SEHK has also been keen to emphasize that aside from a guaranteed allocation, there should be no other direct or indirect benefits to cornerstone investors. In particular, the HKEx in its guidance letter of February 2013<sup>18</sup> indicated that granting other direct or indirect benefits (by side letter or otherwise)—such as waiving brokerage commissions, granting put options to buy back shares after listing, sharing of underwriting commissions, assurances that the issuer will re-invest the IPO proceeds in funds managed by the cornerstone investor or agreements to allow allocation of shares in another IPO—will result in cornerstone investors being re-categorized as pre-IPO investors which will generally result in a significant timetable delay.<sup>19</sup>

Arm's length commercial arrangements between issuers and cornerstone investors—such as when the investors are major customers and suppliers, or formation of joint ventures for business development—are, however deemed acceptable by the SEHK, subject to disclosure of details of such arrangements in the prospectus, on the basis that these are considered as strategic dealings with strategic investors.

The stricter policy evidenced by the guidance note is intended to level the playing field for other IPO investors and enhance transparency of the cornerstone process by ensuring that cornerstone investments represent real demand rather than being investments that would not have been made were they not accompanied by various side-benefits not

17 Practice Note 18, para 4.2 of the Listing Rules provides that where an IPO includes both a placing tranche and a public subscription tranche, the minimum allocation of shares to the subscription tranche should be as follows:

- (a) an initial allocation of 10% of the shares offered in the IPO;
- (b) a clawback mechanism that increases the number of shares to 30% when the total demand for shares in the subscription tranche is 15 times but less than 50 times the initial allocation;
- (c) a clawback mechanism that increases the number of shares to 40% when the total demand for shares in the subscription tranche is 50 times but less than 100 times the initial allocation; and
- (d) a clawback mechanism that increases the number of shares to 50% when the total demand for shares in the subscription tranche is 100 times or more the initial allocation.

Shares may be transferred from the subscription tranche to the placing tranche where there is insufficient demand in the subscription tranche to take up the initial allocation.

18 See Guidance Letter HKEx-GL51-13 (Cornerstone Investment – No Direct or Indirect Benefits to Cornerstone Investors other than Guaranteed Allocation at IPO price) published by HKEx in February 2013.

19 The Interim Guidance on Pre-IPO Investments issued by HKEx in January 2012 requires that, except in exceptional circumstances, pre-IPO investments must be completed either (1) at least 28 clear days before the date of the first submission of the first listing application form or (2) 180 clear days before the first day of trading of the applicant's securities. Furthermore, on 25 October 2012, SEHK published two guidance letters cataloguing which pre-IPO investments are allowed and which ones are not.

available to other investors. Some commentators have expressed concern that the new rules could hamper new listings and may in any event be difficult to enforce in practice, given the challenges of proving the existence and terms of any trade-offs behind the actual deals.<sup>20</sup> On the other hand, there are others who argue that the guidelines do not go far enough, and that the SEHK should also insist that the cornerstone tranche be separated from strategic investments that give one group of investors an advantage over another—this view is premised on the purpose of the IPO exercise which is to raise funds and create a market for the shares, and accordingly strategic investments should be permitted before or after the IPO but not during.<sup>21</sup>

#### 4. Conclusion

Having analysed the role and incidence of cornerstone investors in the context of Singapore, Malaysian and Hong Kong IPOs, it may be safe to conclude that insofar as equity markets remain volatile, cornerstone investors will continue to be critical to the success of IPOs. How cornerstone investors and the cornerstone process are regulated vary from jurisdiction to jurisdiction—it is not the purpose of this article to recommend any one regulatory approach over another, but merely to illustrate that a variety of approaches are possible. Inevitably, the regulatory response in each case is influenced by the regulatory philosophy of regulators in the relevant jurisdiction and would have to be tailored to the nuances of the relevant market. Having said that, it is hoped that a comparative analysis would be helpful in furthering the debate on why and how regulators in Asia and elsewhere should look at this increasingly prevalent and important feature of IPOs.

20 Jing Song, 'HKEx Gets Tough on Cornerstones' *IFR Asia* 785 (2 March 2013).

21 'Cornerstone Cops', *IFR Asia* 785 (2 March 2013).

## Appendix 1: Cornerstone investors in Singapore, Malaysian and Hong Kong IPOs in 2012

Table A1. Singapore (Mainboard and Catalyst)

Company name	Cornerstone investors	Amount invested by cornerstone investors (\$m)	Total amount raised (\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Gaylin Holdings Limited	Nil	0	38.50	0.00%	94.42 times	N/A
Religare Health Trust	Nil	0	510.71	0.00%	14.50 times	N/A
Geo Energy Resources Limited	Nil	0	94.01	0.00%	182.59 times	N/A
Courts Asia Limited	1. JF Asset Management Limited 2. New Silk Road Investment Pte Ltd 3. Target Asset Management Pte Ltd 4. Value Partners Hong Kong Limited	60.00	137.06	43.78%	24.40 times	Nil
Far East Hospitality Trust	1. Aberdeen Asset Management Asia Limited 2. AIA 3. APG Strategic Real Estate Pool 4. Havenport Asset Management Pte. Ltd 5. Hwang Investment Management Berhad 6. Indus Asia Pacific Master Fund, Ltd 7. JF Asset Management Limited 8. Lion Global Investors Limited 9. Myriad Asset Management Limited 10. NTUC Income Co-operative Limited	350.00	656.31	53.33%	14.60 times	Nil
Sysma Holdings Limited (Catalist)	Nil	0	5.04	0.00%	N/A	N/A
Ascendas Hospitality Trust	1. Splendid Asia Macro Fund 2. Lianhe Investments Pte Ltd 3. AHDF Pte Ltd	25.00	409.85	6.1%	6.90 times	Yes, by AHDF Pte Ltd (6 months (100%) and 12 months (50%) after listing)
Sincap Group Limited (Catalist)	Nil	0	6.50	0.00%	N/A	N/A
JB Food Limited	Nil	0	25.20	0.00%	134.82 times	N/A

(continued)



Table A1. Continued

Company name	Cornerstone investors	Amount invested by cornerstone investors (\$\$m)	Total amount raised (\$\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
IHH Healthcare Berhad	See details provided in Table A2.					
	The IPO of IHH Healthcare Berhad involved a primary listing on Bursa Securities and a secondary listing on the SGX					
Neo Group Limited (Catalist)	Nil	0	6.60	0.00%	310.10 times	N/A
Maxi-Cash Financial Services Corporation Ltd (Catalist)	Nil	0	16.80	0.00%	74.30 times	N/A
Swee Hong Limited	Nil	0	22.01	0.00%	16.82 times	N/A
Starland Holdings Limited (Catalist)	Nil	0	4.88	0.00%	N/A	N/A
Global Premium Hotels Limited	Nil	0	117.00	0.00%	86.33 times	N/A
Civmec Limited	Nil	0	40.40	0.00%	56.69 times	N/A
Bumitama Agri Ltd	1. Asdew Acquisitions Pte Ltd	93.00	221.69	42.00%	41.32 times	Nil
	2. Hwang Investment Management Berhad					
	3. Target Asset Management Pte Ltd					
	4. UOB Asset Management Ltd					
	5. Value Partners Hong Kong Limited					
	6. Wii Pte Ltd (a wholly owned subsidiary of Wilmar International Limited)					
Cordlife Group Limited	Nil	0	29.70	0.00%	85.91 times	N/A

**Table A2. Malaysia (Main Market and Ace Market)**

Company name	Cornerstone investors	Amount invested by cornerstone inves- tors (RM million)	Total amount raised (RM million)	Percentage of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Sentoria Group Berhad	Nil	0	51.60	0.00%	5.36 times	N/A
China Stationery Limited	Nil	0	85.50	0.00%	0.50 times	N/A
EITA Resources Berhad	Nil	0	40.28	0.00%	19.47 times	N/A
PESTECH International Berhad	Nil	0	17.48	0.00%	10.47 times	N/A
Gas Malaysia Berhad	Nil	0	734.45	0.00%	21.64 times	N/A
Felda Global Ventures Holdings Berhad	1. Asia Fountain Investment Company Limited	3,291.93	9,932.09	33.14%	6.75 times	180 days
	2. FIL Investment Management (Hong Kong) Limited acting as professional fiduciary for certain accounts					
	3. Guoline Capital Limited					
	4. Qatar Holding LLC					
	5. Certain investment or collective investment(s) and/or managed accounts managed or advised by Value Partners Hong Kong Limited or its subsidiary					
	6. Employees Provident Fund Board					
	7. Permodalan Nasional Berhad					
	8. Lembaga Tabung Haji					
	9. Kumpulan Wang Persaraan (Diperbadankan)					
	10. American International Assurance Bhd					
	11. CMY Capital Sdn Bhd					
	12. Hong Leong Foundation					
OCK Group Berhad	Nil	0	27.00	0.00%	8.30 times	N/A
Gabungan AQRS Berhad	Nil	0	73.16	0.00%	0.51 times	N/A

(continued)

Table A2. Continued

Company name	Cornerstone investors	Amount invested by cornerstone inves- tors (RM million)	Total amount raised (RM million)	Percentage of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
IHH Healthcare Berhad	1. AIA Group Limited's subsidiaries: AIA Singapore Private Limited, American International Assurance Bhd. and American International Assurance Company (Bermuda) Limited 2. Blackrock Investment Management, LLC – Global Allocation Group 3. Capital Group International Inc.s' wholly owned subsidiaries: Capital Guardian Trust Company, Capital International, Inc. and Capital International Sari 4. Capital Research Global Investors 5. CIMB-Principal Asset Management Berhad 6. CMY Capital Markets Sdn. Bhd. 7. Eastspring Investments Berhad 8. Employees Provident Fund Board 9. Fullerton Fund Management Company Ltd 10. The Government of Singapore Investment Corporation Pte Ltd 11. HPL Investors Pte Ltd and Como Holdings Inc. 12. Hwang Investment Management Berhad 13. International Finance Corporation 14. JF Asset Management Ltd 15. Keck Seng (Malaysia) Berhad and Keck Seng Investments (Hong Kong) Limited 16. Kencana Capital Sdn. Bhd. 17. Kuwait Investment Authority 18. Lembaga Tabung Haji 19. Mezzanine Equities N.V. 20. Newton Investment Management Limited 21. OCH-Ziff Capital Management Groups affiliates: OZ Master Fund, Ltd, OZ Asia Master Fund, Ltd, OZ Global Special Investments Master Fund, L.P, Gordel Capital Ltd, OZ ELS Master Fund, Ltd 22. Permodalan Nasional Berhad	3,885.00	6,257.02	62.09%	5.45 times	180 days
Pasukhas Group Berhad	Nil	0	10.80	0.00%	74.04 times	N/A
Datasonic Group Berhad	Nil	0	40.75	0.00%	14.16 times	N/A
IGB Real Estate Investment Trust	Nil	0	837.50	0.00%	21.75 times	N/A

(continued)

Table A2. Continued

Company name	Cornerstone investors	Amount invested by cornerstone inves- tors (RM million)	Total amount raised (RM million)	Percentage of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Astro Malaysia Holdings Berhad	1. Antelle Holding Limited 2. Areca Capital Sdn. Bhd. 3. Aventus Global Opportunities Master Fund Limited 4. Caprice Capital International Ltd 5. Corston-Smith Asset Management Sdn. Bhd. 6. Gordel Capital Ltd 7. Great Eastern Life Assurance (Malaysia) Berhad 8. Kencana Capital Sdn. Bhd. 9. Libra Invest Berhad 10. Myriad Opportunities Master Fund Limited 11. Nomura Asset Management Malaysia Sdn. Bhd. 12. OZ Asia Master Fund, Ltd 13. OZ ELS Master Fund, Ltd 14. OZ Eureka Fund, L.P. 15. OZ Global Special Investments Master Fund, L.P. 16. OZ Master Fund, Ltd 17. Permodalan Nasional Berhad 18. Standard Pacific Capital, LLC 19. Tan Sri Dato' Chua Ma Yu 20. TPG-Axon International, L.P. 21. TGP-Axon Partners, L.P. 22. Universities Superannuation Scheme Limited	1,290.00	4,554.90	28.32%	6.08 times	3 months
Hiap Huat Holdings Berhad ELK-Desa Resources Berhad	Nil Nil	0 0	17.00 29.00	0.00% 0.00%	136.10 times 11.16 times	N/A N/A

**Table A3.** Hong Kong (Main Board)\*

Company name	Cornerstone investors	Amount invested by cornerstone investors (HK\$m)	Total amount raised (HK\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Huazhong Holdings Co Ltd	Nil	0	280.00	0.00%	1.10 times	N/A
Huili Resources (Group) Ltd	Nil	0	425.00	0.00%	0.74 times	N/A
Kai Shi China Holdings Co Ltd	Nil	0	135.00	0.00%	0.25 times	N/A
PC Partner Group Ltd	Nil	0	168.00	0.00%	1.50 times	N/A
ASR Holdings Ltd	Nil	0	93.00	0.00%	20.56 times	N/A
Allied Cement Holdings Ltd	Nil	0	165.00	0.00%	2.96 times	N/A
Vision Fame International Holding Ltd	Nil	0	90.00	0.00%	4.20 times	N/A
Perfect Shape (PRC) Holdings Ltd	Nil	0	220.00	0.00%	32.47 times	N/A
Christine International Holdings Ltd	Nil	0	416.30	0.00%	3.53 times	N/A
Xiawang Special Steel Co Ltd	Nil	0	1325.00	0.00%	1.64 times	N/A
Sunshine Oilsands Ltd	1. Premium Investment Corporation	2712.50	4487.23	60.45%	0.23 times	6 months
	2. Sinopec Century Bright Capital Investment Limited					
	3. TCW Energy Fund XIV, L.P.					
	4. TCW Energy Fund XIV-A, L.P.					
	5. TCW Energy Fund XIV-B, L.P.					
	6. TCW Energy Fund XIV (Cayman), L.P.					
Trigiant Group Ltd	Nil	0	300.00	0.00%	2.37 times	N/A
Kinetic Mines and Energy Ltd	Sany Hongkong Group Limited	211.10	1171.80	18.02%	0.27 times	6 months
Wonderful Sky Financial Group Holdings Ltd	Nil	0	347.50	0.00%	6.84 times	N/A
Juda International Holdings Ltd	Nil	0	55.00	0.00%	0.93 times	N/A
CW Group Holdings Ltd	Nil	0	216.13	0.00%	0.07 times	N/A
Synertone Communication Corporation	Nil	0	99.00	0.00%	1.97 times	N/A
Jiangnan Group Ltd	Nil	0	546.42	0.00%	0.11 times	N/A
China Zhongsheng Resources Holding Ltd	Nil	0	159.60	0.00%	1.30 times	N/A

(continued)

Table A3. Continued

Company name	Cornerstone investors	Amount invested by cornerstone investors (HK\$m)	Total amount raised (HK\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Haitong Securities Co, Ltd—H Shares	1. Albertson Capital Limited 2. D. E. Shaw Valence International, INC. 3. KGI Finance Ltd 4. Leading Investment and Securities Co, Ltd 5. Oman Investment Fund 6. PAGAC Horseshoe Holding I SARL 7. Progress Investment Management Company (BVI) Limited 8. SBI Holdings Inc. 9. Sumitomo Mitsui Trust Bank, Ltd 10. Toyo Securities Company Limited 11. World Prosper Limited Nil Nil	4478.84	14383.14	31.14%	2.86 times	6 months
Dongwu Cement International Ltd Xiezhong International Holdings Ltd Huadian Fuxin Energy Corporation Ltd—H Shares	1. Sinovel Wind Group Co, Ltd 2. CSR Zhuzhou Electric Locomotive Research Institute Co, Limited 3. Huaneng Renewables (Hong Kong) Limited 4. Shanxi Lu'An Mining Industry Group Co, Ltd 5. State Grid International Development Limited 6. GE Pacific Private Limited	0 0 1620.04	150.70 186.00 2677.31	0.00% 0.00% 60.51%	0.88 times 1.17 times 0.94 times	N/A N/A 6 months
China Nonferrous Mining Corporation Ltd	1. COSCO (Cayman) Venus Co Ltd 2. CRCC China-Afric Construction (HK) Limited 3. Wise Pine Investment Limited	545.30	1955.88	27.88%	0.050 times	6 months
Xiao Nan Guo Restaurants Holdings Ltd	Milestone F&B I Limited	170.59	511.87	33.33%	1.15 times	6 months

(continued)





Table A3. Continued

Company name	Cornerstone investors	Amount invested by cornerstone investors (HK\$m)	Total amount raised (HK\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
Future Land Development Holdings Ltd	1. Golden China Master Fund	616.30	2056.10	29.97%	0.25 times	6 months
	2. Guangdong Finance Investment International Co, Ltd					
	3. Axis International Investment Co, Ltd					
Zhengzhou Coal Mining Machinery Group Co Ltd—H Shares	1. China Huadian HongKong Company Limited	930.01	2295.24	40.52%	0.20 times	6 months
	2. Eldon Development Ltd					
	3. Topful Holdings Limited					
The People's Insurance Co (Group) of China Ltd—H Shares	4. Yitai (Group) HK Co, Ltd					
	1. American International Group, Inc	13709.93	27606.63	49.66%	17.54 times	6 months
	2. China Life Insurance Group Company					
	3. China Export & Credit Insurance Corporation					
	4. China Reinsurance (Group) Corporation and China Property & Casualty Reinsurance Company Ltd					
	5. Scor SE					
	6. Tokio Marine & Nichido Fire Insurance Co, Ltd					
	7. Ingosstrakh Insurance Company					
	8. State Grid Yingda International Holdings Corporation Ltd					
	9. China Aerospace Investment Holdings Ltd					
	10. China National Machinery Industry Corporation					
	11. Yue Xiu Securities Holdings Ltd					
	12. Zijin Mining Group Company Limited					
	13. Fosun International Limited					
	14. Munsun Financial Investment Fund LP					
	15. China Southern International Select Allocation Fund					
	16. Zhongrong International Trust Co, Ltd					
	17. Pinpoint Asset Management Limited					

(continued)

**Table A3. Continued**

Company name	Cornerstone investors	Amount invested by cornerstone investors (HK\$m)	Total amount raised (HK\$m)	% of IPO amount subscribed by cornerstone investors	Subscription level	Lock-up period
China Machinery Engineering Corporation—H Shares	1. Nanjing Turbine & Electric Machinery (Group) Co, Ltd	1278.76	4458.78	28.68%	57.88 times	6 months
	2. China Overseas Finance Investment Limited					
	3. Xi Lian International Co, Ltd					
	4. CSR (Hong Kong) Company Limited					
	5. The People's Insurance Company (Group) of China Limited					
China Silver Group Ltd Wilson Engineering Services Co Ltd	Nil	0	215.55	0.00%	8.76 times	N/A
	1. Solar City Holdings Limited	388.50	1854.30	20.95%	1.32 times	6 months
	2. EA Asia Absolute Return Master Fund					
	3. Chow Tai Fook Nominee Limited					

\*Source: Bloomberg and HKEx.