[Fordham Journal of Corporate & Financial Law](https://ir.lawnet.fordham.edu/jcfl)

Volume 14 | Issue 3 Article 3

2009

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CORNERSTONE INVESTORS AND INITIAL PUBLIC OFFERINGS ON THE STOCK EXCHANGE OF HONG KONG

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ABSTRACT

The Stock Exchange of Hong Kong had an exuberant year in 2006 when it listed sixty-two companies. The listing of the Industrial and Commercial Bank of China Limited on its Main Board earned the exchange the enviable status of being home to the world's largest initial public offering. The HK$333.2 billion in initial public offering capital raised during the year propelled it to the position of second among global exchanges, behind London but ahead of New York.

This Article examines an increasingly common feature of initial public offerings in Hong Kong, namely, the introduction of "cornerstone investors" whose participation enhances the general receptiveness to a stock offering. This approach does have a significant downside, however. The new category of "cornerstone investor" may not be completely consistent with the principles of equity of the Listing Rules in Hong Kong.

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I. INTRODUCTION

The year 2006 was considered the "Year of Records" for the Stock Exchange of Hong Kong (the "SEHK").[1] On December 28, 2006, the last trading day of that year, the aggregate market capitalization of the 1,173 listed companies totaled a record HK$13,339.9 billion[2] (approximately US$1.71 trillion).[3] The Hang Seng Index, the benchmark of the SEHK, closed at a record 20001.91 points.[4] Trading was extremely robust throughout the year. Numerous records were set with total market turnover (approximately HK$8.38 trillion), average daily turnover (approximately HK$33.9 billion), and single-month turnover (approxi-

1. *See* HONG KONG EXCHS. & CLEARING, LTD., MARKET STATISTICS 2006, http://www.hkex.com.hk/news/hkexnews/0701122news.xls [hereinafter MARKET STATISTICS 2006] (statistics and analysis in this Article cover a period of establishment of the Stock Exchange of Hong Kong starting from April 1986 through December 31, 2006).

2. *See id*. There were 975 companies listed on the Main Board and another 198 on the Growth Enterprise Market ("GEM") as of December 31, 2006. Sometimes commentators in Hong Kong refer to the GEM as the "Second Board" due to its objective of providing an alternative listing mechanism for companies that do not meet the stricter quantitative and/or qualitative requirements for a listing on the Main Board governed by Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong, Ltd. *See* HONG KONG EXCHS. & CLEARING, LTD., RULES GOVERNING THE LISTING OF SECURITIES ON THE STOCK EXCHANGE OF HONG KONG LIMITED, http://www.hkex.com.hk/rule/listrules/listrules.htm (last visited Feb. 14, 2009) [hereinafter LISTING RULES]. A further set of rules, namely the Rules Governing the Listing of Securities on the Growth Enterprise Market of Hong Kong Exchanges and Clearing, Ltd. (the "GEM RULES"), apply to issuers seeking a listing on the Growth Enterprise Market. *See* GROWTH ENTERPRISE MARKET, http://www.hkgem.com/root/e_default.asp (last visited Feb. 4, 2009); *see also* C. K. Low, *A Brave New World: The Stock Exchange of Hong Kong Holds Court*, 21 J. INT'L BANKING L. & REG. 8, 464 (2006) (arguing that these rules are contractual by nature).

3. The Hong Kong dollar (HK$) trades at a range of HK$7.75 to HK$7.85 per U.S. dollar (US$). This paper uses an exchange rate of US$1 to HK$7.80 as this was the best rate rounded up to two decimal points as quoted on Jan. 15, 2007. *See* Exchange Rates Table for American Dollar, http://www.x-rates.com/d/USD/table.html (last visited Feb. 4, 2009); *cf*. Currency Board System, http://www.info.gov.hk/hkma/eng/currency/link_ex/index.htm (last visited Feb. 4, 2009).

4. *See* HANG SENG INDEXES CO. LTD., http://www.hsi.com.hk (last visited Jan. 29, 2009) (providing an overview of the constituents and computation of the different indices). The benchmark Hang Seng Index is comprised of 39 companies as of Dec. 4, 2006. *See* FAFs and Weightings of HSI Constituents, http://main.hsi.com.hk/hsicom/new/faf_weightings_e.xls (last visited Jan. 29, 2009).

mately HK$1.08 trillion).[5] Records were also set with equity capital raised during initial public offerings ("IPOs") at HK$333.2 billion[6] and total equity capital at HK$505.9 billion.[7] In addition, the SEHK became home to the largest IPO in the world with its successful listing of the Industrial and Commercial Bank of China on October 27, 2006.[8] The SEHK listed 2,823 new derivative warrants during 2006, contributing roughly HK$1.79 trillion (US$229.5 billion) in trading turnover.[9]

A significant contributor to Hong Kong's explosive market dynamics in 2006 was the enthusiasm for the listings of H-shares[10], which are foreign shares issued with a nominal value in Renminbi by Mainland Chinese companies that are listed on the SEHK and traded in Hong Kong Dollars.[11] The increasing importance of such companies to the continued prominence of SEHK as one of the world's leading stock exchanges[12] is highlighted by the fact that the top ten IPOs on the SEHK in

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5. *See* MARKET STATISTICS 2006, *supra* note 1. The corresponding amounts in U.S. currency are about US$1.05 trillion, US$4.35 billion and US$138.46 billion, respectively. For convenience, all of these amounts have been rounded up to the second decimal point.

6. *See id.*

7. *See id.* The amount raised from IPOs during 2006 was approximately US$42.72 billion, while the total equity capital raised was about US$64.86 billion.

8. *See* Chris Oliver, *ICBC offering raises $19 billion; world's biggest IPO*, MARKETWATCH, Oct. 20, 2006, http://www.marketwatch.com/News/Story/Story.aspx?guid=%7B1C3D03AC-5988-4646-B8CB-571483B78682%7D&siteid=mktw.

9. *See* MARKET STATISTICS 2006, *supra* note 1. The previous records were set in 2005 when the 1,682 newly listed derivative warrants contributed towards HK$856.6 billion or about US$109.82 billion in trading turnover. *Id*.

10. *See generally* LISTING RULES, *supra* note 2, at ch. 19A, *available at* http://www.hkex.com.hk/rule/listrules/Chapter_19A.pdf (defining H shares as "overseas listed foreign shares which are listed on the Exchange").

11. The Renminbi, or "RMB," is the currency of the People's Republic of China, which had, until July 21, 2005, been officially pegged to the U.S. Dollar at the rate of US$1 equal to RMB8.28. *See, e.g.*, Richard McGregor, *China ends renminbi's decade-old peg to dollar*, FIN. TIMES, Jul. 21, 2005, *available at* http://www.ft.com/cms/s/f56082a0-f9d9-11d9-b092-00000e2511c8.html. The RMB has since appreciated steadily and consistently to the exchange rate of US$1 to RMB7.80, which is at parity to the Hong Kong dollar. This paper will be using this rate as this was the best rate rounded up to two decimal points. *See* XE – Universal Currency Converter, http://www.xe.com/ucc/convert.cgi (last visited Feb. 4, 2009). Although RMB denominated accounts may be maintained at selected banks in Hong Kong the currency is not freely convertible. *See* Wikipedia, Renmibi, http://en.wikipedia.org/wiki/Renminbi (last visited Feb. 5, 2009).

12. With a 63.1 percent increase in aggregate market capitalization of its listed

2006 involved the sale of H-shares, each of which raised more than HK$20 billion (US$2.56 billion), individually.[13] The trading of H-shares also accounted for eight of the top ten largest listed companies in terms of turnover in 2006.[14] Their combined annual turnover of HK$1.81 trillion (US$232 billion) represented approximately 21.6 percent of the total market turnover achieved by all companies listed on the SEHK in 2006, the significance of which is amplified by the fact that two of these eight companies were only listed since June 1 of that year.[15]

Even amidst growing concerns over the state of the IPO market in the United States,[16] a rising sense of energy in Hong Kong brought to the foreground a number of related issues, including the high rates of over-subscription and the extent of under pricing.[17] This Article examines yet another dimension of IPOs that gained prominence in Hong Kong throughout 2006, namely, the increasing incidence of the introduction of "cornerstone investors"[18], whose participation in an IPO is viewed positively, particularly amongst retail investors.[19] While

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companies during 2006, the SEHK (referred to as Hong Kong Exchanges & Clearing) ranks sixth globally behind the New York Stock Exchange, Tokyo Stock Exchange, Nasdaq Stock Market, London Stock Exchange, and Euronext. *See FOCUS*, WORLD FED'N OF EXCH., Jan. 2007, *available at* http://www.world-exchanges.org/publications/Focus107.pdf.

13. *See* MARKET STATISTICS 2006, *supra* note 1, at 14.

14. *See Id.* at 15.

15. H-Shares of the Bank of China, Ltd. and the Industrial and Commercial Bank of China were listed on June 1, 2006 and Oct. 27, 2006, respectively. HKExnews New Listing Report 2006, *available at* http://www.hkexnews.hk/reports/newlisting/2006.XLS.

16. *See, e.g.*, Henry Blodget, *How U.S. IPOs Lost Their Pop*, NEWSWEEK INT'L, May 15, 2006, at 44.

17. *See* C. K. Low, *The Duties of Directors in 'Irrationally Exuberant' Initial Public Offerings*, 2 VA. L. & BUS. REV. 89, 99, 108 (2007).

18. *See* Prospectus of Bank of China, Ltd 114-19, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060518/3988/F115_e.pdf (providing typical descriptions of cornerstone investors); Kate Linebaugh, *Hong Kong Elite Score on IPOs – Tycoons Received Star Treatment; Big Allotments Are Now Criticized But Once Helped Deals Get Done*, WALL ST. J., June 2, 2006, at C1 [hereinafter Linebaugh, *Star Treatment*]; Kate Linebaugh, *Chinese IPO Gets Star Investors*, WALL ST. J., Sept. 25, 2006, at C4 [hereinafter Linebaugh, *Star Investors*].

19. A typical IPO in Hong Kong comprises two tranches namely "International Placing Shares" and "Hong Kong Offer Shares" which are commonly referred to as the "International Offer Shares" and "Public Offer Shares" respectively. The former is reserved for institutional investors, while Hong Kong Offer Shares is the "retail tranche" of the IPO that is available for direct subscription by the general public. The

acknowledging that such investors may contribute to the success of the IPO, this Article points out that the creation of this new category of investor violates the spirit of the regulatory framework in Hong Kong.

II. A PRIMER ON LISTING IN HONG KONG[20]

The SEHK is a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited, the latter of which is itself a for-profit public company that was listed by way of introduction on the SEHK in July 2000.[21] The principal function of the SEHK is to provide a fair, efficient and orderly market for the trading of securities; it is empowered to prescribe such requirements for companies seeking or maintaining a listing as are necessary to attain these objectives.[22] These requirements are set out in separate but broadly similar Listing Rules for the Main Board and the Growth Enterprise Market ("GEM") of the SEHK.[23]

The GEM is essentially designed to provide emerging enterprises – companies that have good business ideas and growth potential, but which do not meet the profitability or track record requirements of the Main Board of the SEHK – with access to the capital markets.[24] Its launch coincided with the technology boom of the late 1990s, during which there was an apparent need for such a market to facilitate the listing of low profitability/high growth potential companies in Hong Kong and Mainland China. Investing on the GEM thus involves greater risk, premised on the principle of caveat emptor, or "buyer beware", which is evidenced by its greater volatility vis-à-vis the Main Board.

Despite its relative success in raising approximately HK$45 billion (US$5.8 billion) for the 220 companies that listed between the year of its inception and 2005, the GEM has nonetheless suffered a steady decline

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term "retail investor" refers to members of the public who submit direct applications for the Hong Kong Share Offer portion of IPOs. *See* Low, *supra* note 17, at n.10.

20. *See* HONG KONG EXCHS. & CLEARING, LTD., LISTING IN HONG KONG: A QUALITY MARKET (2008), *available at* http://www.hkex.com.hk/issuer/listhk/Aug08_LIHK_E.pdf (providing an overview of the listing process and continuing obligations thereafter).

21. *See* HONG KONG EXCHS. & CLEARING, LTD., LISTING DOCUMENT (June 27, 2000), *available at* http://www.hkex.com.hk/relation/lstdoc/lstdoc.htm.

22. *See* Securities and Futures Commission Ordinance, 2003, Cap. 571, §§21-24 (H.K.), *available at* http://www.legislation.gov.hk/eng/home.htm.

23. *See* LISTING RULES, *supra* note 2.

24. *Id.* at chs. 11, 24-25 (describing the goal and purpose of the GEM).

in recent years.[25] The majority of GEM listed securities presently trade below their IPO price; the companies experienced losses or prolonged periods of suspensions which contributed to the general market illiquidity.[26] This prompted the Hong Kong Exchanges and Clearing Limited to consult the market on the possible restructuring of GEM in January 2006 to determine the approach that best suits the present needs of the various stakeholders.[27] The scope of this Article will thus focus exclusively on IPOs on the Main Board of the SEHK.

Although an IPO is the most common mode of seeking a listing on the SEHK, it is not the only method. A "placing" or an "introduction" may be considered under appropriate circumstances.[28] A "placing" is the obtaining of subscriptions for, or the sale of shares by, a company or intermediary primarily from or to selected persons, the criteria for which is set out in Appendix 6 of the Listing Rules titled Placing Guidelines for Equity Securities.[29] An "introduction" is the ideal method for the listing of companies whose shares are so widely held that adequate marketability can be assumed.[30] An introduction is particularly appropriate for companies seeking a secondary listing in Hong Kong.[31] In every case, the company must satisfy both the quantitative and qualitative criteria that are set out in Chapter 8 of the Listing Rules.[32]

The SEHK mandates that at least 25 percent of the company's shares be held by investors who are independent of the directors and substantial shareholders of the company in order to ensure an adequate

25. *See* HONG KONG EXCHS. AND CLEARING, LTD., Discussion Paper on the Growth Enterprise Market 3 (Jan. 2006), *available at* http://www.hkex.com.hk/consul/paper/gemdp_e.PDF.

26. *See id.*

27. *See id* at 1.

28. The IPO could proceed by way of either an offer for subscription by the company that involves the new issue of shares or an offer for sale by its existing shareholders. Proceeds from the former will go to the company while the vendor shareholders will be the main beneficiaries of the offer for sale. *See* LISTING RULES, *supra* note 2, at ch. 7.

29. *See* LISTING RULES, *supra* note 2, at vol. 2 app. 6.

30. *Id.* at R. 7.13.

31. *Id.* at R. 7.14(1).

32. *Id.* at ch. 8. These criteria should be read in conjunction with the "General Principles" that are set out in Rules 2.03 to 2.06 which emphasize matters such as the maintenance of a fair and orderly market, ensuring fair and equal treatment of investors and keeping them fully informed, and having directors meet their fiduciary obligations. *See id.* at ch. 2.

open market for the freely transferable shares for which listing is sought.[33] This threshold may be reduced to as low as 15 percent at the discretion of the SEHK for companies whose market capitalization will exceed HK$10 billion (US$1.28 billion) on the date of their listing.[34]

Apart from the regulatory framework, any decision to list a company will be driven by an assessment of whether the proposed terms of the IPO are acceptable to both the company and its targeted investors. This consideration has gravitated toward an objective and easily ascertainable benchmark: the pricing of the IPO. The SEHK adopts a system that combines both book building and public offers to provide companies and their underwriters with more flexibility in securing sufficient interest for an IPO.[35]

Book building is an important price discovery mechanism because it allows for the advance gathering of indications of interest from across a wide spectrum of potential investors.[36] Central to the book building process is the ability of the underwriter to control the allocation of shares, so long as the shares are sold at the same price. This process involves the company and its underwriter setting an initial price range and inviting bids for its shares during the "road show" to promote its forthcoming IPO. Investors respond by indicating both the number of shares sought as well as the price that they are willing to pay. Thus, with proper coordination, book building can effectively enable the company and its underwriter to reduce the risks associated with the IPO by securing guarantees from investors to buy a sufficient number of the shares.[37]

To ensure the broadest possible spread of shareholding for the "Public Offer" portion of the IPO and to enhance the fair treatment of investors, the SEHK has mandated the establishment of a "two pool" system for the allocation of shares in all IPOs.[38] Under this system, the

33. *Id.* at R. 8.08.

34. *Id.* at 8.08(1)(d).

35. *See* Ann E. Sherman, *Global Trends in IPO Methods: Book Building versus Auctions with Endogenous Entry*, 78 J. FIN. ECON. 3, 615 (2005) (reviewing the differences between various modes for IPOs and giving a review of finance literature on the subject).

36. *Id.* at 616.

37. *Id.* at 615.

38. *See* THE STOCK EXCH. OF HONG KONG, LTD., PRACTICE NOTE 18 TO THE RULES GOVERNING THE LISTING OF SECURITIES (June 26, 1998), *available at* http://www.hkex.com.hk/rule/listrules/PN18.doc [hereinafter PRACTICE NOTE 18]. Practice Note 18

total number of shares that are available for public subscription under the IPO is divided equally into two pools, "Pool A" and "Pool B".[39] The former must be allocated on an equitable basis to those subscribing for shares with a value of $5 million or less, while the latter applies on the same basis for those whose applications exceed a value of $5 million.[40] Where one of the pools is under-subscribed, the surplus shares must be transferred from the under-subscribed pool to the other and allocated accordingly.[41] This system is further refined in the following manner when the IPO involves a placing tranche:[42]

- The subscription tranche should be no less than 10 percent of the shares offered in the IPO;
- This will increase to 30 percent via a clawback mechanism should the subscription tranche be oversubscribed by between 15 and 50 times;
- The threshold will be further increased to 40 percent where the rate of oversubscription is between 50 and 100 times; and
- At least 50 percent of the shares must be available for allocation under the subscription tranche if the oversubscription rate exceeds 100 times. In such an event, both the placing and the subscription tranches would comprise the same number of shares.[43]

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applies to the retail portion of the IPO, which is available for direct subscription by the general public.

39. *Id*.

40. *Id*.

41. *Id*.

42. *See id.* at 2. This placing tranche is also generally known as the "International Placing Shares" or "International Offer Shares", which is set aside for the book building process during which the company and its advisers will organize road shows for institutional investors. Under normal circumstances, this placing tranche will constitute 90 percent of the total number of shares offered during the IPO, although companies may apply for a waiver of strict compliance with Practice Note 18 to increase this proportion to a maximum of 95 percent.

43. *Id*. Investors may choose to apply for shares in either the placing tranche or the subscription tranche, or for both tranches should these be completed simultaneously. However, to ensure fairness in the event of the latter, shares may only be allocated to the investor from either the placing or the subscription tranche but not from both.

The foregoing "clawback" provisions do not apply to over-allotment or "green shoe" options that are granted to the underwriter, who retains sole discretion on how they are to be allocated.[44]

III. A REVIEW OF INITIAL PUBLIC OFFERINGS IN 2006

The fifty-three IPOs during 2006 raised a collective total of approximately HK$332.1 billion (US$42.6 billion) in new equity capital.[45] However, not all of funds raised are received by the company, as the IPO may comprise a combination of an offer for subscription as well as an offer for sale. While the company receives money from an offer for subscription, it is the existing shareholders who benefit from an offer for sale, since this involves the disposal of a portion of their shareholding.[46]

Although the average size of the fifty-three IPOs during 2006 was approximately HK$6.3 billion (US$803 million), the range was signify-cantly larger, between HK$11 million (US$1.4 million) raised by Winbox International (Holdings) Limited[47] and about HK$125 billion (US$16 billion) by the Industrial and Commercial Bank of China Limited, the largest IPO in the world.[48] The successful listing of the

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44. *See, e.g.*, Investopedia, Greenshoe Option, http://www.investopedia.com/terms/g/greenshoe.asp (last visited Feb. 5, 2009). It is customary for companies to grant greater than 15 percent of the number of offer shares to its underwriters under such a "green shoe" or over-allotment option which may be exercised at the discretion of the underwriter within 30 days of the close of the IPO; Franze SA & Schlag C, *Over-allotment Options in IPOs on Germany's Neuer Market – An Empirical Investigation* (CFS Working Paper No. 2002/16), *available at* http://www.soc.uoc.gr/econ/static_content/seminars/Schlag.pdf.

45. *See* New Listing Report 2006, *supra* note 15.

46. *See* LISTING RULES, *supra* note 2, at R. 7.01-.08. The existing shareholders of seven companies sold some of their shares as part of the IPO in 2006. These "sale" or "existing shares" were offered for sale by the existing shareholders of Fortune Sun (China) Holdings Limited (the shareholders of which sold 20.28 million "sale shares" during the IPO before the exercise of over-allotment options), Greentown China Holdings Limited (25.974 million), Hembly International Holdings Limited (7.2 million), Smart Union Group (Holdings) Limited (12 million), AUPU Group Holding Company Limited (34 million), Neo-Neon Holdings Limited (40 million), and The Ming An (Holdings) Company Limited (99 million). *See id.*

47. *See* New Listing Report 2006, *supra* note 15.

48. *See* Oliver, *supra* note 8. The Industrial and Commercial Bank of China, Ltd., attained the distinction of being the first company to be simultaneously listed on the SEHK and on the Shanghai Stock Exchange. This amount of HK$125 billion pertains to that which the company raised on the SEHK.

Industrial and Commercial Bank of China provides further irrefutable evidence of the increasing importance of companies that are incorporated in the People's Republic of China ("PRC") and to the continued prominence of the SEHK as one of the top ten stock exchanges globally in terms of market capitalization.

Appendix I sets out the details of the fifty-three IPOs of 2006. It is noteworthy that the top five fundraisers for the year collectively raised some HK$266 billion (US$34.1 billion), accounted for 80 percent of the total funds raised from IPOs during 2006, and all involved the sale of "H-shares": the Industrial and Commercial Bank of China Limited, Bank of China Limited, China Communications Construction Company Limited, China Coal Energy Company Limited and China Merchants Bank Company Limited.[49] An emerging facet of IPOs in Hong Kong, particularly with the larger sized issues and those involving the sale of H-shares, is the increasing prominence of corporate investors, also referred to as "cornerstone investors". The practice of allocating a specified number of shares to cornerstone investors during an IPO in Hong Kong is substantially different from the practice of "spinning",[50] which was evident in the United States during the height of the dot-com technology boom of the late 1990s.[51] In essence, "spinning" involves the directing of highly sought after shares during IPOs to preferred clients, assuring those clients of instant profits when they sell the shares immediately upon the commencement of trading.[52] In return, the under-

49. *See infra* app. I. Each of the top five IPOs raised more than HK$15 billion or US$1.923 billion. In fact, the 17 H-Shares that were listed on the SEHK in 2006 raised a combined total of HK$290 billion (US$37.2 billion), accounting for approximately 87.3 percent of the total funds raised for the year. The two largest listings, namely those of the Industrial and Commercial Bank of China and the Bank of China, raised a combined total of HK$211.7 billion (US$27.1 billion), comprising about 73 percent of the total value of H-Share IPOs for 2006.

50. The data of cornerstone investors was hand collected and compiled with a review of all the prospectuses that were issued by companies seeking a listing over a five-year period from 2002 through 2006. This desk survey by the author indicated a marked absence of such investors prior to the year 2006. *See, e.g.*, *infra* notes 60, 120-25 [hereinafter *Desk Survey*].

51. *See* Morrison & Foerster, *"Spinning" IPO Shares: The* eBay *Decision*, Feb. 2004, http://www.mofo.com/news/updates/files/update1162.html [hereinafter eBay *Decision*]; *see also* News Release, NASD Charges Frank Quattrone with Spinning, Undermining Research Analyst Objectivity, Failure to Cooperate in Investigation (Mar. 6, 2003), http://www.nasd.com/PressRoom/NewsReleases/2003NewsReleases/NASDW_002948.

52. eBay *Decision*, *supra* note 51.

writers are promised lucrative advisory work or high commission trades on other stocks, a practice that has been viewed recently by the Supreme Court of New York as "a sophisticated form of bribery."[53]

The rationale for the introduction of cornerstone investors during IPOs is based on the perception that the credibility of some of the companies that are going public needs to be enhanced.[54] Public investors may also be concerned about the standards of corporate governance practiced by the companies, as well as the level of transparency or reliability of their accounts. The presence of household names as cornerstone investors is thus often viewed as an implicit seal of approval, since the list includes some of the richest tycoons in Hong Kong. By committing their own funds – or funds of companies in which they have controlling interest – and by agreeing not to dispose of the shares so allotted within a specified "lock-up" period[55], these cornerstone investors boost confidence and deliver a positive signal to the market. In addition, their participation reduces the number of shares that have to be sold on the open market, which not only promotes the success of the IPO but also upholds a degree of confidence in the stability of the company's share price thereafter.

Nevertheless, the presence of cornerstone investors raises two related issues: (i) whether such arrangements benefit the company going public, and (ii) whether they breach applicable regulations. The ensuing sections of this Article argue that while the allocations to cornerstone investors do not breach the letter of the law if there is adequate disclosure of such arrangements, there is nonetheless a need to rethink the rules to enhance the principles of equity during an IPO. This Article concludes with a proposal that strikes a balance between the interests of the various stakeholders, without requiring any burdensome change to the regulatory framework.

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53. *See* State v. McLeod, 12 Misc. 3 1157(A), 1 (2006); State v. McLeod, Settlement Agreement in the Supreme Court of the State of New York (2006), *available at* http://www.oag.state.ny.us/press/2006/jul/McLeod%20Settlement%20Stipulation.pdf.

54. *See infra* notes 120-25.

55. The "lock-up" period refers to the period of time that the cornerstone investor agrees not to dispose of the shares and is the quid pro quo for being accorded a preferential status in the allotment of the shares by the company. *See infra* note 59; *see also* Prospectus of the Bank of China, Ltd., *supra* note 18, at 114-19 (typical description of cornerstone investors and of the "lock up period").

IV. AN ASSESSMENT OF THE INCIDENCE OF CORNERSTONE INVESTORS

A company's decision whether to invite the participation of cornerstone investors in its IPO is essentially a commercial one. The principal regulatory criterion is that the cornerstone investors must be independent from both the company and the controlling shareholders.[56] Once the decision is made, the company and cornerstone investors enter into corporate placing agreements in which the cornerstone investors irrevocably agree to subscribe for as many shares as may be purchased with a fixed amount of investment. The exact number of shares ultimately depends on the final price set for the IPO, and this number is then rounded down to the nearest "board lot" to facilitate trading.[57]

All the pertinent details of these arrangements must be prominently disclosed in the prospectus. To assess the extent of participation of cornerstone investors, a desk survey was conducted of the prospectuses from the website of the Hong Kong Exchanges and Clearing, the primary purpose of which was to ascertain, among other things: (a) the identity of the cornerstone investors and the quantum of their investment; (b) the number of shares that were placed to them and the restricttions imposed thereon; and (c) the effect of such arrangements on both the institutional and retail tranches of the IPO.[58] Table 1 below presents a snapshot of the results of the desk survey.

56. *See* LISTING RULES, *supra* note 2, Rules 8.07-.08 (requirement for assuring an adequate and open market for the securities that are listed).

57. A "board lot" is the number of shares that are traded for a particular company through the electronic trading system of the SEHK. There is no uniform size of board lots in Hong Kong; this number may be determined from time to time by the company. For example HSBC Holdings plc (Stock Code Number 5) has a trading board lot of 400 shares while its 62 percent owned subsidiary Hang Seng Bank Limited (Stock Code Number 11) has a board lot of 100 shares. The trading of "odd lots", namely where the quantity of shares do not amount to a "board lot", is generally done over-the-counter between buyers and sellers. *See* Hong Kong Exchs., Market Operations & Infrastructure, http://www.hkex.com.hk/infra1.htm (last visited Feb 6, 2009) (for an overview of the securities trading and settlement systems in Hong Kong).

58. To facilitate the widest possible dissemination of pertinent corporate information, the prospectuses of companies that seek a listing on the SEHK are posted on the website of the Hong Kong Exchanges and Clearing. *See* Listed Company Information Advanced Search – Current Securities, http://www.hkexnews.hk/listedco/listconews/advancedsearch/search_active_main.asp (last visited Feb. 6, 2009) [hereinafter Advanced Search – Current Securities]; *see also Desk Survey*, *supra* note 50.

Table 1: Participation of cornerstone investors in IPOs during 2006[59]

Name of company	Amt sought from IPO (HK$B)	Number of cornerstone investors	Total amount committed (HK$M)	Lock-up period (months)
Nine Dragons Paper (Holdings) Ltd.	$3.4 (US$435.9m)	3	$468 (US$60m)	6
Bank of China Ltd. H-Shares	$76.7 (US$9.83b)	12	$17,521 (US$2,246m)	12
China BlueChemical Ltd. H-Shares	$2.66 (US$341m)	4	$646 (US$82.8m)	9
Industrial & Commercial Bank of China Ltd. H-Shares	$108.65 (US$13.93b)	13	$30,800 (US$3,948.7m)	12
Zhaojin Mining Industry Co. Ltd. H-Shares	$2.19 (US$280.1m)	4	$341 (US$43.7m)	6
China Communications Construction Co. Ltd. H-Shares	$16.1 (US$2.06b)	3	$1,950 (US$250m)	12
Shanghai Jin Jiang Int'l Hotels (Group) Co. Ltd. H-Shares	$2.42 (US$310.3m)	2	$312 (US$40m)	6
China Coal Energy Co. Ltd. H-Shares	$13.15b (US$1.69b)	5	$1,950 (US$250m)	12

Appendix II sets out the beneficial owners of cornerstone investors and the size of their individual investments as published in the prospectuses. The last column calculates the approximate percentage of all the shares from the IPO that was allotted to these investors based on the final offer price as announced by the company. The ensuing paragraphs review some of the more significant features of these arrangements in Hong Kong.

59. *See* Advanced Search – Current Securities, *supra* note 58; *see also Desk Survey*, *supra* note 50. The stock codes for the companies in Table 1 are Nine Dragons Paper (2689), Bank of China (3988), China BlueChemical (3983), ICBC (1398), Zhaojing Mining (1818), China Communications Construction (1800), Shanghai Jin Jiang (2006) and China Coal (1898). For links to electronic copies of each of the listed companies' prospectuses, see *infra* note 75.

A. Who are the cornerstone investors?

The cornerstone investors are among the "Who's Who" in Hong Kong and figure prominently among its richest citizens.[60] Individuals from the January 2007 Forbes Asia list included Dr. Lee Shau Kee, who ranked second with a net worth estimated at US$16.5 billion;[61] Dato Dr. Cheng Yu Tung who ranked seventh with a net worth of US$6.5 billion; Mr. Peter Woo Kwong Ching, whose US$2.7 billion placed him fourteenth on the list; and Mr. Chen Din Hwa, who came close behind with US$2.6 billion.[62] Although not on the Greater China list, the presence of Mr. Kuok Hock Nien is also significant as he ranked among the richest people in the world with diversified business interests in plantations, media, hotels and property.[63]

A number of prominent companies that are listed on the SEHK also appear consistently on the list of cornerstone investors. These include Cheung Kong (Holdings) Limited and its subsidiary Hutchison Whampoa Limited, which boasts Dr. Li Ka Shing, the richest man in Hong Kong as of January 2007, as its controlling shareholder.[64] The list also includes Sun Hung Kai Properties Limited, which is controlled by the Kwok brothers,[65] and Chinese Estates Holdings Limited, which is run by Mr. Joseph Lau.[66]

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60. *See Greater China's Richest: The Top 40*, FORBES ASIA, Jan. 29 2007, *available at* http://www.forbes.com/global/2007/0129/035.html [hereinafter *China's Top 40*].

61. It is telling that the reference to Dr. Lee in Forbes Asia reads as follows: "Made fortune in property as founder of Henderson Land. Adding to wealth through investments in such recent IPOs as Nine Dragons." Dr. Lee who is known as "Hong Kong's Warren Buffet" in the market has been widely reported in the local media as saying that there is more profit to be made in equities than in property development. *See* Jeffrey Tam, *Lee Talks Up Equities for New Year*, THE STANDARD, Jan. 2, 2007, at A3; Danny Chung, *Lee Focus Pledge*, THE STANDARD, Dec. 13 2006, at A1.

62. *See China's Top 40*, *supra* note 60.

63. *See The World's Richest People: #114 Robert Kuok*, FORBES.COM, http://www.forbes.com/lists/2006/10/ARHN.html (with an estimated net worth of about US$5 billion Mr. Kuok ranked as 114th in the world in 2006).

64. *See China's Top 40*, *supra* note 60. Forbes Asia estimated the net worth of Dr. Li to be about US$22 billion. *Id.*

65. *Id.* The brothers Raymond, Thomas and Walter Kwok are collectively estimated to be worth an estimated US$14 billion by Forbes Asia, which places them as the third richest in Hong Kong.

66. *Id.* At an estimated net worth of US$1.95 billion, Mr. Lau ranks 23rd on the Forbes list. He recently set a world record for purchasing the most expensive Andy

Tycoons aside, yet another group of prominent cornerstone investors to emerge in 2006 was state-owned investment companies, which include the Government of Singapore Investment Corporation[67] the Kuwait Investment Authority[68] and the Qatar Investment Authority.[69] Together, these three entities purchased HK$10 billion (US$1.28 billion) of shares during the IPO of the Industrial and Commercial Bank of China Limited, and were allotted about 9.19 percent of all of the shares offered.[70] In addition, the Mainland Chinese government-controlled China Life Insurance (Group) Company Limited and its SEHK-listed subsidiary, China Life Insurance Company Limited, were featured as cornerstone investors in four of the IPOs: Bank of China Limited, the Industrial and Commercial Bank of China Limited, China Communications Construction Company Limited and China Coal Energy Company Limited.[71]

B. Lock-up period

The "lock-up" period refers to the duration of time following the listing date during which cornerstone investors are not permitted – directly or indirectly – to dispose of the shares that they have been allotted during the IPO.[72] The purpose of this provision is to ensure that the shares are not "flipped" for immediate profit akin the practice of "spinning" described above. This restriction, however, does not appear to be an absolute prohibition since its language allows for a degree of flexibility, enabling early disposals of the shares by cornerstone

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Warhol painting, "Mao", for US$17.5 million. *Id.*

67. Government of Singapore Investment Corp. (GIC), http://www.gic.com.sg (last visited Feb. 15, 2009).

68. Kuwait Investment Authority, http://www.kia.gov.kw (last visited Feb. 15, 2009).

69. The Qatar Investment Authority, http://www.qia.qa/QIA (last visited Feb. 15, 2009).

70. *See* ICBC IPO Announcement Result, http://www.hkexnews.hk/listedco/listconews/sehk/20061026/1398/F104.pdf (highlighting the allocation to corporate (cornerstone) investors). The Government of Singapore Investment Corporation was also a cornerstone investor in China Communications Construction Company, Ltd., where it received about 4.03 percent of all of the shares sold during the IPO in return for its investment of HK$650 million, or about US$83.33 million. *Id.*

71. *See Desk Survey*, *supra* note 50; Table 1, *supra* note 59.

72. *See supra* note 55 and accompanying text.

investors with the company's consent. For example, the prospectus of Bank of China Limited – H-Share states that:

> Each Corporate Investor and its respective investor parent (if any) has agreed that, without our prior written consent or that of the Joint Global Coordinators, it will not, whether directly or indirectly, at any time during the period of twelve months following the Listing Date, dispose of any H Shares subscribed pursuant to the International Offering (or any interest in any company or entity holding any of the H Shares), other than transfers to another company which is and will remain wholly-owned by the Corporate Investor or its investor parent or, in certain cases, its holding company, and such transfer can only be made when the transferee agrees to be subject to the restrictions on disposals imposed on the Corporate Investor.[73]

The prospectuses of seven other companies whose IPOs had cornerstone investors featured language similar to the foregoing condition, save for some differences in the 'lock up' period.[74] The term "Corporate Investor" was used by all but one of the companies, the exception being Shanghai Jin Jiang International Hotels (Group) Company Limited which used the term "Cornerstone Investor" in its prospectus.[75]

Although the lock-up period for China BlueChemical Limited was ostensibly nine months, a closer review of its terms reveals a clause that mitigated its restrictiveness. The cornerstone investor

> may freely transfer or otherwise dispose of such number of H Shares that constitute up to 50 percent of the H Shares subscribed for pursuant to the relevant corporate placing agreement without the consent of our Company and the Joint Global Coordinators at any time

73. *See* Prospectus of the Bank of China, Ltd., *supra* note 18, at 119.

74. *See* Nine Dragons Paper (2689) 138, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060220/02689/EWP117.pdf; China BlueChemical (3983) 266-67, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060918/03983/EWP125.pdf; ICBC (1398) 101, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20061016/01398/EWP114.pdf; Zhaojing Mining (1818) 101, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20061124/01818/F116.pdf; China Communications Construction (1800) 67, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20061201/1800/F115_e.pdf; Shanghai Jin Jiang (2006) 278, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20061130/02006/EWP126.pdf; China Coal (1898) 224, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20061206/1898/F124_e.pdf.

75. *Supra* note 74.

> and from time to time after the date falling six months from the Listing Date.[76]

The effective lock-up period was therefore six months for half of the shares allotted and nine months for the balance, and may be further varied with the consent of the company.[77]

Except as disclosed in the prospectus, there was no requirement for either the company or its cornerstone investors to provide information regarding any granting of approval for disposals of shares within the lock-up period.[78] Furthermore, as their equity holding was invariably below five percent of the issued capital of the company, cornerstone investors were not classified as "substantial shareholders," which are required to disclose acquisitions and disposals of their shares.[79] Taken together, these factors contributed to an undesirable lack of transparency for share transactions by cornerstone investors within the lock-up period, as their activities may have ranged from the purchase of shares or, with the written consent of the company, a sale of shares within the initial allocation of shares from the IPO.

C. Preferred and guaranteed allotment

In return for their commitments, cornerstone investors are accorded priority status in the allotment of shares during IPOs. Corporate placing agreements include the following term:

> The Offer Shares to be subscribed by each of the Corporate Investors will not be affected by any reallocation of the Offer Shares between the International Offering and the Hong Kong Public Offering in the event of over-subscription under the Hong Kong Public Offering as described.[80]

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76. *See* China BlueChemical (3983) 266-67, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060918/03983/EWP125.pdf.

77. *See id.*

78. As the arrangement for cornerstone investors is by definition a private contract between the company, its underwriters and the investor, this information is not subject to any further disclosure, save for what appears in the prospectus as well as the announcement on the IPO Allotment Results.

79. *See* Securities and Futures Commission Ordinance, *supra* note 22, § 15.

80. Prospectus of the Bank of China, Ltd., *supra* note 18, at 114. The prospectuses of the other seven companies whose IPOs had cornerstone investors contained the same statement or words to similar effect.

The allotment of shares to cornerstone investors is thus contractually guaranteed and the only aspect that remains to be determined is the final offer price used for the computation of the number of shares. This preferred allotment is not affected by the rate of oversubscription for the Hong Kong Public Offer that triggers the application of the "clawback" provisions of Practice Note 18.[81] In short, the parties who would lose out from any reallocation of shares from the International Offer Share tranche to the Hong Kong Offer Share tranche would be institutional investors who are not accorded the status of cornerstone investors.

While the provisions of Practice Note 18 effectively require the company to disclose the rate of oversubscription for the retail tranche of its IPO, there is no corresponding requirement for the company to do so for its International Offer Share portion. Instead of providing a precise number, companies may choose to use terms such as "significantly", "substantially" or "well" oversubscribed to describe the institutional demand. This makes it difficult to quantify the overall demand for the shares of a company during its IPO.[82] Indeed, the International Offer Shares portion of seven of the eight IPOs that involved cornerstone investors in 2006 were "very substantially over-subscribed," making it reasonable to draw two conclusions.[83] First, there was substantially more demand than supply of shares, which in turn means that all institutional investors likely received fewer shares than they had sought. Second, these investors would seek to rebalance their investment portfolios through the acquisition of additional shares on the open market when trading commenced. All else being equal, this demand virtually guaranteed that the shares would experience a strong performance in terms of price to the benefit of those who were fortunate enough to be allotted shares during the IPO.

Notably, the average rate of oversubscription for the retail tranche of the eight IPOs that had cornerstone investors in 2006 was about 308 times.[84] Under normal circumstances, this would require a readjustment of the number of Hong Kong Public Offer Shares to 50 percent of the

81. *See* PRACTICE NOTE 18, *supra* note 38; *see also infra* discussion in the section titled "Waiver of Practice Note 18."

82. *See infra* Table 2; *see also infra* note 92.

83. *Id.* The exception is Zhaojin Mining Industry Company, Ltd., which reported that the International Offer Shares tranche of its IPO was "significantly oversubscribed." *Id.*

84. Computed by author as an average based on the actual rates of oversubscriptions as set out in Table 2.

total number of shares available during the IPO, thus further decreasing the number of shares that institutional investors – excluding cornerstone investors – could expect to receive under the International Offer Share portion.[85] It is against this background that the guarantee of allocation of shares to cornerstone investors is particularly significant, especially coming as it did during a year when the average rate of oversubscription of the Hong Kong Public Offer portion exceeded 250 times, with the retail tranche of at least ten IPOs being over-subscribed by 500 times or more.[86]

Collectively, cornerstone investors were allotted an average of almost 28 percent of the adjusted number of International Offer Shares from the eight IPOs in which they participated.[87] This ranged from approximately 15.1 percent for China Communications Construction Company Limited – H-Share, to 48.5 percent for China BlueChemical Limited – H-Share.[88] The latter is especially significant, as there were only four cornerstone investors who were able to secure almost one-half of all the International Offer Shares with a collective investment of about HK$646 million (US$82.8 million) despite the company's announcement that this tranche was "very significantly over-subscribed".[89] Of more fundamental importance is the fact that the engagement of cornerstone investors by companies concentrated shareholdings in the hands of a select and privileged few, rather than ensuring the widest possible base of shareholders.

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85. *See* PRACTICE NOTE 18, *supra* note 38. Cornerstone investors therefore enjoy a preferential status since their allocation is fixed and is not subject to any reduction regardless of the rate of over subscription for the retail tranche unlike other institutional investors. In return, however, the cornerstone investors agree not to dispose of their shares within a specified lock-in period.

86. *See* C. K. Low, *Initial Public Offerings and Interest Income in Hong Kong*, 18 EUR. BUS. L. REV. 559 (2007).

87. Table 2 sets out the statistics from hand-collected data from various announcements by the company, including its prospectus and IPO Allotment Results. The adjusted number of shares reflects the reallocation to the retail tranche based on the claw-back provisions of Practice Note 18, but excludes any shares that the company may subsequently issue to institutional investors under the green shoe over allotment option. *See infra* section titled "Waiver of Practice Note 18."

88. *See infra* section titled "Waiver of Practice Note 18."

89. *See* China BlueChemical, Ltd., IPO Allotment Results, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060928/LTN20060928001.htm. The four cornerstone investors were allotted an aggregate of about 24.27 percent of the total number of shares offered in the IPO before the exercise of the green shoe over allotment option by the underwriters.

Table 2 below provides a succinct summary of the preferred positions of cornerstone investors who were guaranteed allotments of shares from the International Offer Share portion of IPOs in 2006.

Table 2: Clawback effect of application of Practice Note 18[90]

Name of company	Rate of over subscription for Hong Kong Offer Shares	Revised number of Int'l Offer Shares (Millions)	Rate of over subscription for International Offer Shares	Percentage of International Offer Shares allotted to cornerstone investors
Nine Dragons Paper (Holdings) Limited	520.45	500	Very Significantly Oversubscribed	27.52
Bank of China Ltd. H-Share	70.9	23,011.731	Very Significantly Oversubscribed	25.8
China BlueChemical Ltd. H-Share	477.56	700	Very Significantly Oversubscribed	48.57
Industrial & Commercial Bank of China Ltd. H-Share	75.74	31,851.9	Very Significantly Oversubscribed	31.49
Zhaojin Mining Industry Co. Ltd. H-Share	535.75	86.4	Significantly Oversubscribed	31.12
China Communications Construction Co. Ltd. H-Share	219.97	2,800	Very Significantly Oversubscribed	15.13
Shanghai Jin Jiang International Hotels (Group) Co. Ltd. H-Share	382.18	550	Very Significantly Oversubscribed	25.78
China Coal Energy Co. Ltd. H-Share	182.08	2,597.098	Very Significantly Oversubscribed	18.48

90. *See Desk Survey*, *supra* note 50.

D. Waiver of Practice Note 18

Four companies, namely Bank of China Limited, the Industrial and Commercial Bank of China Limited, China Communications Construction Company Limited, and China Coal Energy Company Limited, sought and received a waiver from strict compliance of Practice Note 18, thus amplifying the share concentration effects that cornerstone investors had during the 2006 IPOs.[91] The underlying rationale for the waiver was that it is generally more difficult and costly to market large-sized IPOs to retail investors.[92] Given the uncertainty of demand for the Hong Kong Offer Share portion, it was deemed more prudent to reduce the initial size of this tranche and reallocate these shares to the International Offer Share tranche because interest from institutional investors is relatively easier to ascertain from the road shows that the company conducts.[93]

These waivers work at two levels. [94] First, the Hong Kong Public Offer Shares portion of the IPO is halved from the usual ten percent to five percent. Second, in the event of significant oversubscription of the retail tranche, the reallocation, or "clawback", from the International Offer Shares portion is substantially reduced from its customary levels under Practice Note 18. Such waivers were relatively uncommon prior to 2006, as only eight were granted in total. One such waiver was granted in each of the years 2001, 2002 and 2003; two were granted in 2004 and three in 2005.[95] Their popularity has increased steadily in recent

91. This data was hand-collected by the author from a review of the prospectuses of the companies. The waiver was also granted to a fifth company, China Merchants Bank Co., Ltd., but this is not pertinent to the current discussions as its IPO did not have any cornerstone investors. It is interesting to note, however, that these are coincidentally the five largest IPOs for 2006. *See* Structure of Global Offering 352-54, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20060908/03968/EWP124.pdf.

92. The usual practice of the SEHK is to consider such Practice Note 18 waiver applications only where the size of the IPO exceeds HK$10 billion, or US$1.28 billion, before the exercise of the green shoe over-allotment option. This practice is consistent with Rule 8.08(1)(d) which allows for the exercise of discretion on the part of the SEHK to reduce the public shareholding base to 15 percent of the issued capital of a company which market capitalization is expected to exceed HK$10 billion on its listing. *See* LISTING RULES, *supra* note 2, at R. 8.08.

93. Based on market observation from discussions with investment bankers.

94. *See infra* note 101.

95. From a review of prospectuses the waivers were previously granted to CNOOC, Ltd., in 2001, China Telecom, Ltd. in 2002, China Life Insurance, Ltd. in 2003, SMIC Ltd. and Ping An Insurance, Ltd. in 2005, and China Construction Bank,

years, however, congruent with the listings of larger Mainland Chinese enterprises on the SEHK.

The table below illustrates the effect that such waivers have in markedly reducing the number of shares that would otherwise be available for subscription by retail investors thereby depriving them of a higher degree of participation especially for the 'hot' IPOs that were prevalent in 2006.

Table 3: Effect of waivers of Practice Note 18 on Hong Kong Offer Share portion of IPO[96]

	Initial percentage of IPO set aside for Hong Kong Public Offer	Clawback adjustment for oversubscription of between 15 and 50 times	Clawback adjustment for oversubscription of between 50 to 100 times	Clawback adjustment if oversubscription exceeds 100 times
Normal Practice	10%	30%	40%	50%
With waivers	5%	7.5%	10%	20%

One consequence of granting such waivers is the retail frenzy that is generated over IPOs. As with the company, retail investors face the uncertainty of not knowing what the demand will eventually be for the Public Offer Shares, as this will only be determined at the close of the IPO. Recognizing that the size of the "clawback" provisions is reduced in tandem with the initial allocation for the retail tranche of the IPO, investors have turned increasingly towards the use of margin financing.[97]

Ltd., China Shenhua Ltd. and Bank of Communications, Ltd. in 2005. All of the foregoing are H Shares. *See supra* note 75 (providing links to electronic copies of each of the listed companies' prospectuses).

96. The figures presented in this Table are based on announcements by brokers concerning the provision of such financing during IPOs and the author's experience.

97. The term "margin financing" refers to the amount of money that investors borrow for the purposes of purchasing securities, which includes shares offered during IPOs. *See* The Free Dictionary, Financial Dictionary, Margin, http://financial-dictionary.thefreedictionary.com/Margin (last visited Feb. 6, 2009); Deacons, *Tightening Securities Margin Financing in Hong Kong* (Nov. 30, 2004), http://www.hg.org/articles/article_468.html.

As the shares of China Coal Energy Company Limited IPO'd at HK$4.05 and closed at HK$4.56 at the end of its first day of trading on the SEHK,[98] an investor with one board lot of shares would have made a gross profit of approximately HK$510, assuming that he or she managed to sell the shares at the closing price. This profit, however, does not take into account the costs, the principal components of which would include brokerage for both subscribing for and selling the shares, application fees (if any) and the interest that is incurred on the margin financing.

The following table illustrates the effects that the waivers may have had indirectly on contributing to increases in the size of the applications – and the costs thereof – to the retail investor just to be assured of being allocated one board lot of shares. It should be noted that Bank of China Limited pursued a policy which guaranteed every single retail investor one board lot of 1,000 shares to encourage them to apply for its IPO.

Table 4: Size and cost of application to be assured allotment of one board lot where waivers of Practice Note 18 have been granted by the SEHK[99]

Name of company	Number of shares to apply for to be assured of one board lot	Cost of subscription (HK$)
Bank of China Ltd. H-Share	1000	3030.30
Industrial and Commercial Bank of China Ltd. H-Share	6000	18,606.04
China Communications Construction Co. Ltd. H-Share	20000	92,928.28
China Coal Energy Co. Ltd. H-Share	25000	102,271.61
China Merchants Bank Co. Ltd. H-Share	5000	43,181.78

The foregoing analysis raises three questions that may be posed by retail investors. First, is the waiver of Practice Note 18 necessary or

98. *See* Yahoo! Finance, www.finance.yahoo.com (last visited Feb. 15, 2009); *China Coal Energy Co. Lists in Hong Kong*, PEOPLE'S DAILY ONLINE, Dec. 19, 2006, http://english.peopledaily.com.cn/200612/19/eng20061219_334087.html.

99. The details as set out in Table 4 were hand collected from the IPO Allotment Results announcements by the companies. Disclosure as set out under the "Basis of Allotment under the Hong Kong Public Share Offering" was examined to determine the level of application required to secure the allotment of one board lot of shares.

equitable? Second, should such a waiver be granted in cases that involve cornerstone investors who are assured of being allotted a significant number of these highly sought after shares? Lastly, why should investors who put up all of their application monies up-front be subject to such uncertainties, especially in view of the investments necessary to be assured of being allotted one board lot of the shares of the company?[100]

E. Bottom line: How profitable is it to be a cornerstone investor?

There is no dispute that cornerstone investors expose themselves to a degree of risk that is inherent in any IPO. For example, the issue may not be well received by other investors or it may be affected by externalities, either before the listing of the company or during the lock-up period, that may cause a decline in the price of the shares.

This risk appeared to be neither material nor substantial, however, at least during the 2006 IPO boom. Concededly, as of December 31, 2006, the lock-up period had only expired for one of the eight IPOs, Nine Dragons Paper (Holdings) Limited, whose shares closed at HK$6.97 on September 4, 2006, the first trading day after the lock-up period.[101] Had the three cornerstone investors sold all of their shareholdings at that price on that day, they would have more than doubled their money on the investment with a collective profit estimated at HK$491.4 million before costs.[102] Nevertheless, the cornerstone investtors would have done much better had they kept their shareholdings through the end of 2006, as the company was the best performing IPO of

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100. In the interest of full disclosure, the author was appointed as a member of the Listing Committee of the Stock Exchange of Hong Kong on May 19, 2006 and has participated in the hearings of a number of listing applications as well as of other issues since then. The views expressed in this Article are solely and exclusively those of the author in his personal capacity.

101. *See* Yahoo! Finance, *supra* note 98; *see also* UK & Ireland Yahoo! Finance, Nine Dragons Paper Historical Prices (Sept. 4, 2006), http://uk.finance.yahoo.com/q/hp?s=N3Y.BE&b=4&a=08&c=2006&e=4&d=08&f=2006 (listing the historical share price for Sept. 4, 2006 in United Kingdom currency).

102. As they are not defined as substantial shareholders of the company the cornerstone investors are under no obligation to notify the company and/or the SEHK of the sale of their shares. The profit of some US$63 million is based on the three cornerstone investors being collectively allotted about 137.64 million shares in return for the US$60 million that they invested. The profit would have been HK$3.57 for each share, ignoring transaction costs.

the year. Its shares closed at HK$13.40 on December 29, 2006, representing a 294 percent premium over its IPO price.[103] The following table highlights the gross unrealized gains attained by the cornerstone investors of the other seven IPOs in which they participated. These gains are particularly impressive when one considers that three of the companies were only listed on the SEHK from December 2006.[104]

Table 5: Return on investment for cornerstone investors in 2006[105]

Name of company	IPO Date	IPO Offer Price (HK$)	Closing share price 12/29/06	% gain on investment
Bank of China Ltd. H-Share	6/01/06	2.95	4.27	44.75
China BlueChemical Ltd. H-Share	9/29/06	1.90	3.15	65.79
Industrial & Commercial Bank of China Ltd. H-Share	10/27/06	3.07	4.83	57.33
Zhaojin Mining Industry Co. Ltd. H-Share	12/08/06	12.68	15.52	22.4
China Communications Construction Co. Ltd. H-Share	12/15/06	4.60	7.69	67.17
Shanghai Jin Jiang Int'l Hotels (Group) Co. Ltd. H-Share	12/15/06	2.20	3.73	69.55
China Coal Energy Co. Ltd. H-Share	12/19/06	4.05	5.05	24.69
Avg. % gain to end 2006		**N/A**	**N/A**	**50.24**

103. The last trading day for the year was December 29, 2006. If the cornerstone investors had sold all of their shareholdings at the closing price for the day, they would have had HK$10, or US$1.28, per share for a collective gross profit of about HK$1.37 billion, or US$176.4 million.

104. Bank of China, Ltd. was listed on the SEHK on June 1st, China BlueChemical, Ltd., on September 29th, and Industrial and Commercial Bank of China on October 27th, while Zhaojin Mining Industry Company, Ltd. and China Communications Construction Company, Ltd., Shanghai Jin Jiang International Hotels (Group) Company Ltd. and China Coal Energy Company Ltd., were listed on December 8th, 15th and 19th of 2006, respectively. TodayIR, http://www.todayir.com/e/ipo_2006.php (last visited February 15, 2009). The lock-up periods for these companies had not expired as of December 31, 2006. *See* Table 1 *infra* and Appendix I *supra*.

105. *See* New Listing Report 2006, *supra* note 15 (setting out the IPO Date and IPO Offer Price). The closing price is obtained from Yahoo! Finance, www.finance.yahoo.com.

The foregoing provides a succinct snapshot of the enviable rates of return achieved by the cornerstone investors in the months or weeks since their initial investments in the companies. Admittedly, these figures did not represent realized gains, as the cornerstone investors were obliged to retain these shares through the end of the lock-up period unless the company consented in writing to an earlier disposal of the same. Furthermore, the high rates of return may have been influenced by the general upward trend of the market. Nonetheless, these figures provide strong evidence of the potentially significant profits to be made by cornerstone investors, especially in markets similar to the SEHK in 2006, with first day returns averaging more than 22 percent for the fifty-three IPOs in that year.[106]

The closing price of the shares on December 29, 2006 is used for two principal reasons. First, it allows for the identification of a convenient and specific point of comparison to ensure consistency while contemporaneously reflecting the interaction between market demand and supply. Second, there is usually no provision of an official opening price for a particular share by the stock exchange on which it is traded. The closest to an official opening price might be the figure determined by the single-auction pricing process during the pre-opening session. For example, in the year 2002 the SEHK introduced the "Bid and Ask Record" with the principal objective of assisting in the determination of fair opening prices for shares, by disseminating 30-second snapshots of the equilibrium prices during the pre-opening session for each share, with the last equilibrium price before actual market opening adopted as the best estimate of the single-auction price.[107] This is not necessarily a transaction price, however, and the process may be subject to manipulation aimed at distorting the price discovery mechanism.

106. *See* Low, *supra* note 17, at 101; *see also* Sundeep Tucker, *Hong Kong Warned of Chinese IPO Dependence*, FIN. TIMES, Jan. 16, 2007, http://www.ft.com/cms/s/d9634f66-a4ef-11db-b0ef-0000779e2340,dwp_uuid=9c33700c-4c86-11da-89df-0000779e2340.html (acknowledging and describing how the listings of Mainland Chinese companies have benefited the development of the SEHK).

107. HKEx Data Products, Product Subscription, https://www.hkex.com.hk/ods/English/asp/prdProfile.asp?prd=000000096&groupID=000000100&scheme=1 (last visited Feb. 6, 2009).

V. RETHINKING THE REGULATORY FRAMEWORK

Cornerstone investors have contributed to the development of the market particularly during the initial listings of increasingly larger sized Mainland Chinese companies at the turn of the new millennium. Their participation helped provide the necessary confidence and stability of share price without which the H-Share market might not be as buoyant as it is today.

A case in point is that of China Telecom Corporation Limited, whose IPO in November 2001 was marred by unfavorable market conditions and fundamental management errors, including the release of earnings forecasts and information on planned acquisitions that were not in the prospectus.[108] These factors contributed to the lackluster response to its IPO, with an International Share Offer portion that was described as being "fully subscribed" while the retail tranche was only 3.6 times covered.[109] In that case, commentators noted that the investment of US$50 million by Hutchison Whampoa Limited, a telecom and port conglomerate controlled by Dr. Li Ka Shing, was "seen as a vote of confidence in China Telecom by the territory's retail investors."[110]

Although the Listing Rules do not specifically deal with the subject, the issue of cornerstone investors is neither recent nor novel. Indeed, the topic has been canvassed in a number of publications with headlines, including: "HK Tycoons Pledge $500m for China Life IPO";[111] "Tycoons Get China Netcom IPO Rolling with $1.1b Pledge";[112] "Hong

108. *See* China Telecom Corp., Ltd. 1, *available at* http://www.hkexnews.hk/listedco/listconews/sehk/20021114/LTN20021114035.pdf.

109. *Id.* (using the term "fully subscribed" suggests a weak demand with the order book possibly barely filled, despite the International Offer Shares being fully placed by the underwriters).

110. *See, e.g.*, Joe Leahy, *Li Puts $50m into China Telecom IPO*, FIN. TIMES LONDON, Nov. 8, 2002, at 30. The IPO had to be priced at the lowest end of its indicative range of between prices. The company was set at HK$1.47 per H-Share. If Hutchison Whampoa, Ltd. had held on to all of the shares allotted through the end of 2006, it would have achieved gross return on its investment of approximately 190 percent over five years, as the price of China Telecom Corp., Ltd., closed at HK$4.26 on December 29th, 2006.

111. *See* Joe Leahy, Angela MacKay & Francesco Guerrera, *HK Tycoons Pledge $500m for China Life IPO*, FIN. TIMES LONDON, Dec. 5, 2003, at 1.

112. *See* Hui Yuk-min & Nicole Chan, *Tycoons Get China Netcom IPO Rolling with $1.1B Pledge*, S. CHINA MORNING POST, Oct. 29, 2004, at 1.

Kong Elite Score on IPO";[113] "Chinese IPO Gets Star Investors";[114] and "Front Running in China".[115] Taking a cue from these publications (albeit not alluding specifically to cornerstone investors), the Listing Committee of the SEHK in its 2006 Annual Report formed the opinion that:

> While the Committee does not consider pre-IPO placings shortly before listing to be objectionable, the Committee considered that preferential investment terms available only to pre-IPO investors may at times be inconsistent with the principle that all holders of listed securities are to be treated fairly and equally, memorialized in Rule 2.03. This would particularly be the case in circumstances where the terms of the pre-IPO investment meant that private equity investors would not have experienced equity risks significantly different from those experienced by public investors, or would be protected from certain types of equity risks after listing in a manner that was significantly different from that experienced by public investors. In such cases the Committee considered it appropriate to require the preferential terms to be removed or altered prior to listing in order to satisfy the principles of Rule 2.03.[116]

To the extent they apply, the General Principles of Rule 2.03 require that "all holders of listed securities are treated fairly and equally"[117] as the rules attempt to secure for securities holders certain assurances and equality of treatment which their legal positions might not otherwise provide. But, while the ambit of Rule 2.03 and the issue of pre-IPO placements have been considered in a number of separate Listing Decisions,[118] none of these pertain to the specific circumstances of cornerstone investors.

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113. *See* Kate Linebaugh, *Star Treatment*, *supra* note 18.

114. *See* Kate Linebaugh, *Star Investors*, *supra* note 18.

115. *See* Shu-Ching Jean Chen, *Front-Running in China*, FORBES, Dec. 1, 2006, http://www.forbes.com/business/2006/12/01/china-ipo-investors-biz-cx_jc_1201china ipo.html (last visited Feb. 6, 2009).

116. *See* THE LISTING COMM, ANNUAL REPORT 2006 7, para. 26 (2006), *available at* http://www.hkex.com.hk/listing/listcomrpt/AnnualRpt_2006.pdf.

117. *See* LISTING RULES, *supra* note 2, R. 2.03(4), at 2-2, *available at* http://www.hk ex.com.hk/rule/listrules/Chapter_2.pdf.

118. *See* Listing Decision HKEx-LD55-1 (June 2006), http://www.hkex.com.hk/ listing/listdec/listdec_dates_06_07.htm; Listing Decision HKEx-LD56-1 (Sept. 2006), http://www.hkex.com.hk/listing/listdec/listdec_dates_06_08.htm (reaffirming the views of Listing Decision HKEx-LD36-1 (Oct. 2003), http://www.hkex.com.hk/listing/listdec/ 200310-1.doc).

The discussion thus far highlights significant issues for policymakers and securities regulators in Hong Kong to resolve. First, is the risk of having a less than definitive lock-up period a fair trade for the certainty of securing shares in highly sought after IPOs? Second, does the perpetuation of a system that enables cornerstone investors to be accorded privileged status in the allotment of shares facilitate or impair the further development of the market? Lastly, and perhaps most importantly, does this issue pertain to the freedom of contract between companies and their underwriters in the lead up to an IPO, or has it become an issue of circumventing the Listing Rules by contract?

One possible solution would be to refine the ambit of Practice Note 18 by expressly stating that the preferential allocation of shares before or during an IPO would prima facie be presumed to be inconsistent with the fair and equitable principles of the Listing Rules. This approach is preferred for two principal reasons. First, a Practice Note issued pursuant to Rule 1.06 is intended "to assist issuers . . . or their advisers in interpreting and complying with these Exchange Listing Rules."[119] Such an approach has the advantages of familiarity, expediency and flexibility, as practitioners have adhered to the procedures and processes since the introduction of Practice Note 18 in June 1998. It does not completely prohibit participation by cornerstone investors, but rather, it puts a burden on the company and its advisers to rebut the presumption with substantial quantitative and qualitative assessments that are sufficiently objective to enable the Listing Committee of the SEHK to consider the merits of such an application.

Furthermore, as the foregoing does not involve any amendments to the Listing Rules, it is unnecessary to undergo the time consuming procedure set out in Rule 2.05, which provides that any such amendments must be "subject to the approval of the Commission under section 24 of the Securities and Futures Ordinance."[120] Section 24 of the Securities and Futures Ordinance requires the SEHK to provide, inter alia, explanations of the purpose as well as the likely effects of such amendments,[121] which invariably necessitates a public consultation on the issue. Such exercises tend to be cumbersome and fraught with conflicting opinions,

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119. *See* LISTING RULES, *supra* note 2, R. 1.06, at 1-14, *available at* http://www.hkex.com.hk/rule/listrules/Chapter_1.pdf.http://www.hkex.com.hk/rule/listrules/Chapter_1.pdf.

120. *See* LISTING RULES, *supra* note 2. The term 'Commission' refers to the Securities and Futures Commission of Hong Kong.

121. *See supra* note 19, § 7.24(2), at 7-8.

often reflecting the range of vested interests, making it rather difficult to do much more than compromise on the lowest common denominator.[122] An amendment of the Listing Rules may also reduce the degree of flexibility afforded the SEHK, thereby depriving it of the discretion necessary to maintain its preeminent position in an increasingly competitive world of financial markets.

A useful benchmark that the SEHK may adopt in its interpretation of the revised Practice Note 18 may be to initially determine whether the investor is classified as "purely financial" or "strategic" by the listing company. In its present form, the company would most appropriately define a cornerstone investor as a purely financial investor, as cornerstone investors primarily invest with the objective of securing an allotment of shares during an IPO. Such arrangements do not provide for any participation in management or exchange of expertise between the investor and the company, and the investment is usually made during the road shows at which the corporate placement agreements are negotiated and signed.

A strategic investor, on the other hand, is defined as a "[c]orporate or individual investor[] that add[s] value to investments [it or he] makes through industry and personal ties that can assist companies in raising additional capital as well as provide assistance in the marketing and sales process."[123] Strategic investors normally make their investments in the company well ahead of the planned IPO and their lock-up periods tend to be for a longer duration.

All else being equal, a strategic investor has potentially more to offer the company than a purely financial investor, who offers only an investment of a specific amount of money. Naturally, the strategic investor should also give due consideration to the duration and quality of the investment ahead of the IPO, as well as of the lock-up period thereafter. In addition, the company and its advisers could present evidence of the potential long-term synergies that may result from closer relationships between the company and its strategic investors, which could enhance the benefit to all of its shareholders.

Nevertheless, the foregoing should not be the sole or primary test to determine whether a particular strategic investor ought to be accorded the status of a cornerstone investor. Rather, the overriding test must be

122. *See supra* note 70 (disclosure and disclaimer).

123. *See* VC Experts, Strategic Investors, http://vcexperts.com/vce/library/encyclopedia/glossary_view.asp?glossary_id=112 (last visited Jan. 22, 2009).

whether such an arrangement would be consistent with the principles of fairness and equality of the Listing Rules. Conversely, the proposal to grant a person the preferential allocation of shares as a cornerstone investor should not by itself be seen as a breach of these principles, since this must include an assessment of whether the cornerstone investor has assumed a level of risk that is substantially above that of other investors.

In short, the issue of cornerstone investors should not be reduced to a mere checklist, as these investors can contribute positively to the healthy development of our capital markets. Rather, a critical assessment is required of their contribution to the company over and above the investment of an amount of money during the IPO. In these circumstances, well-publicized and objectively established guidelines should work better than rigid rules since, at the end of the day, it is the balanced and dynamic process that is more important than just a simple arrival at the eventual outcome.

VI. CONCLUSION

Seven of the eight IPOs that had cornerstone investors in 2006 have at least one common feature, namely that they were H-Shares issued by companies that were incorporated in Mainland China. The sole exception is Nine Dragons Paper (Holdings) Limited which, on closer examination, is not markedly different given the scale of its operations on the Mainland as well as the fact that it reports in Renminbi.[124] All of these IPOs were very substantially oversubscribed by both institutional and retail investors who viewed investments in the People's Republic of China favorably given its strong economic growth through 2006, high savings rate and the emergence of a middle class with an increasingly consumption-based pattern of behavior.

The practice of introducing cornerstone investors was originally designed to bolster the confidence of investors in what were essentially semi-privatized state-owned enterprises in Mainland China whose track records were at best uncertain. The marketing of such shares proved difficult during this embryonic stage, as there were many legitimate concerns over transparency and the complicated share structure of the companies, which included "non tradable shares".[125]

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124. *See* Prospectus of Nine Dragons Paper (Holdings), Ltd., *available at* http://www.hkex.com.hk/listedco/listconews/sehk/20060220/LTN20060220006.htm.

125. Approximately two-thirds of the total market capitalizations of Mainland Chinese companies are in the form of illiquid non-tradable shares whose legal status has

Much has changed since the successful listing of the first H-Share, Tsingtao Brewery Company Limited, on the SEHK on July 15, 1993. The pace of reforms has accelerated, particularly since the December 2001 accession of Mainland China into the World Trade Organization, whose obligations include the opening up of its domestic financial markets. As of January 2007, numerous micro and macro policy initiatives were already implemented or were being implemented, including the launch of the Qualified Foreign Institutional Investor Programme[126] and the increasing convergence of Mainland Chinese Generally Accepted Accounting Practices with that of the International Financial Reporting Standards.[127]

In light of the foregoing, one must ask whether the practice of inviting the participation of cornerstone investors for IPOs has outlived its purpose. Rather than being the investment backwaters as it was once regarded, Mainland China has metamorphosed into an economic powerhouse with expectations that it may become the second largest economy in the world behind the United States. Furthermore, despite the supposed risks that are assumed by the cornerstone investors, the evidence suggests that these risks were more perceived than actual in 2006, as the IPOs were exceedingly well received. On a closer examination of the returns that have been made on these investments, one must ask whether such arrangements are intended to benefit the company or its cornerstone investors.

Although cornerstone investors do not violate the Listing Rules – as there are no such provisions to begin with – there is nonetheless a legitimate concern about the fairness of such arrangements. It is difficult, at

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not been definitively clarified. Their origins date back to 1991 to the gradual opening up of stock markets under stringent socialist rules. The presence of these shares causes distortions in the market based upon such concerns over issues like the protection of shareholder rights as well as the possible negative effect of the sale of these stocks. *See, e.g.*, C. H. Kwan, *Reforms of Non-tradable Shares Opening the Way for the Privatization of Major State-owned Enterprises*, 9 NOMURA CAPITAL MKT. REV. 1, 54 (2006), *available at* http://www.nicmr.com/nicmr/english/report/images/ico_reppdf.gif; Frederick Balfour, *A Banner Year for China's Stock Markets*, BUSINESSWEEK, Dec. 26, 2006, *available at* http://www.businessweek.com/globalbiz/content/dec2006/gb20061226_389013.htm?chan=globalbiz_asia_investing.

126. *See* Yang Lei, ed., *China relaxes QFII rules to attract more overseas investment*, GOV.cn, Aug. 25, 2006, http://english.gov.cn/2006-08/25/content_370283.htm.

127. *See, e.g.*, DELOITTE, COMPARISON BETWEEN PRC GAAP & IFRS (Apr. 1, 2005), *available at* http://www.iasplus.com/dttpubs/2005ifrsprc.pdf.

best, to justify their existence in increasingly dynamic markets, especially those like the SEHK in 2006, where demand for shares during IPOs consistently far exceeded the supply. At worst, one could contend that these arrangements serve primarily to allow the underwriters to prefer a select group of investors, in breach of the principles of fairness and equality that are espoused by the Listing Rules. Akin to the practice of "spinning" that prevailed in the United States at the height of the dot-com era of the late 1990s, the practice of allocating shares to cornerstone investors may well be Hong Kong's very own version of "a sophisticated form of bribery".[128]

128. *See supra* note 36.

APPENDIX I: NEW LISTINGS ON THE MAIN BOARD OF THE STOCK EXCHANGE OF HONG KONG

January 1 to December 31, 2006[129]

	Stock Code	Company Name (at time of listing)	Listing Date (dd/mm/yy)	IPO Subscription Price (HK$)	Total Funds Raised (HK$M)	Total Funds Raised (US$M)
1	2398	Good Friend Int'l Holdings Inc.	11/01/06	1.130	79.1	10.141
2	3330	Lingbao Gold Co. Ltd. H-Shares	12/01/06	3.330	989.922	126.913
3	919	Modern Beauty Salon Holdings Ltd.	09/02/06	1.000	180	23.077
4	2788	Yorkey Optical Int'l (Cayman) Ltd.	10/02/06	2.200	506	64.872
5	502	Pan Sino International Holding Ltd.	01/03/06	N/A - By Introduction	0.00	0.00
6	457	O2Micro Int'l Ltd.	02/03/06	N/A - By Introduction	0.00	0.00
7	2689	Nine Dragons Paper (Holdings) Ltd.	03/03/06	3.400	3,910	501.283
8	402	Ming Hing Holdings Ltd.	14/03/06	0.720	57.6	7.385
9	3308	Golden Eagle Retail Group Ltd.	21/03/06	3.150	1,630.125	208.99
10	3323	China National Building Material Co. Ltd. H-Shares	23/03/06	2.750	2,068.919	265.246
11	707	Co-Prosperity Holdings Ltd.	30/03/06	1.160	232	29.744
12	2626	Hunan Nonferrous Metals Corp. Ltd. H-Shares	31/03/06	1.650	2,040.915	261.656

129. Hong Kong Exchs. & Clearing, Ltd., http://www.hkex.com.hk/index.htm (last visited Feb. 6, 2009).

	Stock Code	Company Name (at time of listing)	Listing Date (dd/mm/yy)	IPO Subscription Price (HK$)	Total Funds Raised (HK$M)	Total Funds Raised (US$M)
13	3355	Adv. Semiconductor Manufacturing Corp. Ltd. H-Shares	07/04/06	1.600	748.256	95.93
14	2345	Shanghai Prime Machinery Co. Ltd. H-Shares	27/04/06	2.100	1,450.357	185.943
15	2880	Dalian Port (PDA) Co. Ltd. H-Shares	28/04/06	2.575	2,487.45	318.904
16	3335	DBA Telecommunication (Asia) Holdings Ltd.	11/05/06	1.260	362.25	46.442
17	3382	Tianjin Port Development Holdings	24/05/06	1.880	1,249.636	160.21
18	3988	Bank of China Ltd. H-Shares	01/06/06	2.950	86,741.44	11,120.697
19	474	Winbox Int'l (Holdings) Ltd.	06/06/06	0.550	11	1.41
20	527	Galaxy Semi-Conductor Holdings Ltd.	09/06/06	0.860	86	11.026
21	549	Jilin Qifeng Chemical Fiber Co., Ltd - H Shares	21/06/06	1.690	399.263	51.188
22	515	TC Interconnect Holdings Ltd.	23/06/06	1.000	60	7.692
23	352	Fortune Sun (China) Holdings Ltd.	05/07/06	1.060	74.497	9.551
24	813	Shimao Property Holdings Ltd.	05/07/06	6.250	4,277.453	548.391
25	3900	Greentown China Holdings Limited	13/07/06	8.220	3,069.155	393.481
26	3989	Hembly Int'l Holdings Ltd.	13/07/06	1.700	131.376	16.843
27	3899	Enric Energy Equipment Holdings Ltd.	20/07/06	N/A - By Introduction	0.00	0.00
28	3322	Win Hanverky Holdings Ltd.	06/09/06	2.280	786.6	100.846
29	3303	Jutal Offshore Oil Services Ltd.	21/09/06	1.380	158.7	20.346

	Stock Code	Company Name (at time of listing)	Listing Date (dd/mm/yy)	IPO Subscription Price (HK$)	Total Funds Raised (HK$M)	Total Funds Raised (US$M)
30	3968	China Merchants Bank Co., Ltd. H-Shares	22/09/06	8.550	20,691	2,652.692
31	3983	China BlueChemical Ltd. H-Shares	29/09/06	1.900	3,059	392.179
32	2700	Smart Union Group (Holdings) Limited	29/09/06	1.100	79.2	10.154
33	637	Lee Kee Holdings Limited	04/10/06	2.670	614.1	78.731
34	272	Shui On Land Ltd.	04/10/06	5.350	6,819.22	874.259
35	667	HannStar Board Int'l Holdings Ltd.	06/10/06	1.770	604.013	77.438
36	320	Computime Group Ltd.	09/10/06	2.280	524.4	67.231
37	337	SPG Land (Holdings) Ltd.	10/10/06	4.780	1,374.25	176.186
38	558	L.K. Technology Holdings Ltd.	16/10/06	1.110	277.5	35.577
39	3918	NagaCorp Ltd.	19/10/06	1.430	822.25	105.417
40	1398	Industrial & Commercial Bank of China Ltd. H-Shares	27/10/06	3.070	124,947.926	16,018.964
41	609	Tiande Chemical Holdings Ltd.	27/10/06	1.020	102	13.077
42	1888	Kingboard Laminates Holdings Ltd.	07/12/06	7.730	6,377.25	817.596
43	477	AUPU Group Holding Co. Ltd.	08/12/06	1.230	288.558	36.995
44	552	China Communications Services Corp. Ltd. H-Shares	08/12/06	2.200	3,266.969	418.842
45	1818	Zhaojin Mining Industry Co. Ltd. H-Shares	08/12/06	12.680	2,519.706	323.039
46	528	Kingdom Holdings Ltd.	12/12/06	1.750	301.875	38.702
47	1800	China Communications Construction Co. Ltd. H-Shares	15/12/06	4.600	18,515	2,373.718
48	1868	Neo-Neon Holdings Ltd.	15/12/06	6.900	1,587	203.462

	Stock Code	Company Name (at time of listing)	Listing Date (dd/mm/yy)	IPO Subscription Price (HK$)	Total Funds Raised (HK$M)	Total Funds Raised (US$M)
49	2006	Shanghai Jin Jiang Int'l Hotels (Group) Co. Ltd. H-Shares	15/12/06	2.200	2,783	356.795
50	1388	Embry Holdings Ltd.	18/12/06	3.620	362	46.41
51	1898	China Coal Energy Co. Ltd. H-Shares	19/12/06	4.050	15,119.987	1,938.46
52	3898	Zhuzhou CSR Times Electric Co., Ltd. H-Shares	20/12/06	5.300	2,197.613	281.745
53	1399	SCUD Group Ltd.	21/12/06	2.020	603.98	77.433
54	1899	Xingda International Holdings Ltd.	21/12/06	3.080	1,367.212	175.284
55	1882	Haitian Int'l Holdings Ltd.	22/12/06	3.950	1,576.05	202.058
56	1389	The Ming An (Holdings) Co. Ltd.	22/12/06	1.880	1,514.122	194.118
				Total	**332,083.193**	**42,574.768**

Source: Hong Kong Exchanges and Clearing Limited

APPENDIX II: BENEFICIAL OWNERSHIP OF AND ALLOCATIONS TO CORNERSTONE INVESTORS DURING IPOS IN HONG KONG

January 1 to December 31, 2006[130]

Name of company	Beneficial owner of cornerstone investor (as stated in prospectus)	Amt. invested HK$M (US$M)	Approx. % of all IPO shares allotted to cornerstone investor
Nine Dragons Paper (Holdings) Limited	Mr. KUOK Hock Nien	156 ($20)	4.58
	Dato Dr. CHENG Yu Tung	156 ($20)	4.58
	Dr. LEE Shau Kee	156 ($20)	4.58
Bank of China Limited H-Shares	China Life Insurance (Group) Co. Ltd.@	1,162.92 ($149)	1.54
	China Life Insurance Co. Ltd.@	1,162.92 ($149)	1.54
	The Bank of East Asia, Ltd.	1,395.504 ($178.9)	1.85
	The Bank of Tokyo-Mitsubishi UFJ, Ltd	1,395.504 ($178.9)	1.85
	Cheung Kong (Holdings) Limited*	697.752 ($89.5)	0.92
	Hutchsion Whampoa Limited*	697.752 ($89.5)	0.92
	Dato Dr. CHENG Yu Tung	1,395.504 ($178.9)	1.85
	Dr. LEE Shau Kee	1,395.504 ($178.9)	1.85
	Mr. KUOK Hock Nien	1,395.504 ($178.9)	1.85
	Mr. CHEN Din Hwa^	1,255.954 ($161)	1.66
	Ms. CHEN Wai Wai Vivien^	139.550 ($17.9)	0.18
	Ping An Insurance (Group) of China, Ltd.	1,395.504 ($178.9)	1.85
	Sun Hung Kai Properties Ltd.	1,395.504 ($178.9)	1.85

130. *Id.*

	Sino Land Co. Ltd.	1,240.448 ($159)	1.64
	Mr. Peter WOO Kwong Ching	1,395.504 ($178.9)	1.85
China BlueChemical Ltd. H-Shares	Dr. LEE Shau Kee	195 ($25)	7.33
	Chinese Estates Holdings Ltd.	195 ($25)	7.33
	Bank of China Limited	156 ($20)	5.86
	China Cinda Asset Management Corp.	100 ($12.8)	3.75
Industrial and Commercial Bank of China Limited H-Shares	China Life Insurance (Group) Co. Ltd.@	4,400 ($564.1)	4.04
	China Life Insurance Company Limited@	2,000 ($256.4)	1.84
	Cheung Kong (Holdings) Limited*	800 ($102.6)	0.73
	Hutchsion Whampoa Limited*	800 ($102.6)	0.73
	Dato Dr CHENG Yu Tung	1,600 ($205.1)	1.47
	CITIC Pacific Limited	800 ($102.6)	0.73
	Mr. YUNG Chi Kin	800 ($102.6)	0.73
	Dr LEE Shau Kee	1,600 ($205.1)	1.47
	Government of Singapore Investment Corp.	2,800 ($359)	2.57
	Mr. KUOK Hock Nien	1,600 ($205.1)	1.47
	Kuwait Investment Authority	5,600 ($717.9)	5.15
	Mr. CHEN Din Hwa^	1,440 ($184.6)	1.32
	Ms. CHEN Wai Wai Vivien^	160 ($20.5)	0.14
	Qatar Investment Authority	1,600 ($205.1)	1.47
	Sun Hung Kai Properties Limited	1,600 ($205.1)	1.47
	United Overseas Bank Limited	1,600 ($205.1)	1.47
	Mr. Peter WOO Kwong Ching	1,600 ($205.1)	1.47

Zhaojin Mining Industry Co. Ltd. H-Shares	Standard Bank Plc	93 ($11.9)	4.24
	Mr, HO Tsu Kwok, Charles	93 ($11.9)	4.24
	Dr. LO Ka Shui	77.5 ($9.9)	3.53
	Global Investment House	77.5 ($9.9)	3.53
China Communications Construction Co. Ltd. H-Shares	China Life Insurance (Group) Co. Ltd.@	650 ($83.3)	4.03
	Dato Dr. CHENG Yu Tung	650 ($83.3)	4.03
	Government of Singapore Investment Corp.	650 ($83.3)	4.03
Shanghai Jin Jiang International Hotels (Group) Co. Ltd. H-Shares	Bank of China Limited	156 ($20)	6.44
	Dr. The Hon. Sir David LI Kwok Po	156 ($20)	6.44
China Coal Energy Company Limited H-Shares	Cheung Kong (Holdings) Limited	390 ($50)	2.96
	China Life Insurance (Group) Co. Ltd.@	390 ($50)	2.96
	Dato Dr. CHENG Yu Tung	390 ($50)	2.96
	CITIC Pacific Limited	195 ($25)	1.48
	Mr. YUNG Chi Kin	195 ($25)	1.48
	Dr. LEE Shau Kee	390 ($50)	2.96

Notes:
The IPO Shares do not include any green shoe over allotment options that are exercised.
All commitments in US$ are converted to its Hong Kong counterpart at the rate of US$1 to HK$7.80.
The percentages are rounded down to the nearest second decimal point.
* Hutchison Whampoa Limited is a subsidiary of Cheung Kong (Holdings) Limited. Both companies are listed on the SEHK.
@ China Life Insurance Company Limited is listed on the SEHK and is a subsidiary of China Life Insurance (Group) Company Limited, the latter of which is a state-owned financial and insurance enterprise.
^ Mr. CHEN Din Hwa and Ms. CHEN Wai Wai Vivien are related and together control the unlisted Nan Fung Group Limited whose corporate interests span cotton spinning, shipping, construction, real estate management, and share and securities investments.