



PUBLIC CONSULTATION PAPER

NO. 1/2007

INTRODUCTION OF AN OVER-ALLOTMENT OPTION AND PRICE STABILIZATION MECHANISM FOR INITIAL PUBLIC OFFERINGS

The Securities Commission invites your written comments on the issues set out in this consultative paper. Comments are due by **17 August 2007** and should be sent to:

Regulatory Services (Advisory & Reform)
Office of the General Counsel
Securities Commission
3 Persiaran Bukit Kiara
50490 Kuala Lumpur
e-mail : etchin@seccom.com.my
Fax : +603-6201 5101

Additional copies of this document may be made without seeking permission from the Securities Commission or downloaded from its website at www.sc.com.my.

Confidentiality: Your responses may be made public by the Securities Commission. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only if you request that the information remain confidential.

1. Executive Summary

- 1.1 In order to enhance the efficiency of the fund raising process, the Securities Commission (SC) is proposing to introduce changes to the regulatory framework to provide for an over-allotment option and price stabilization mechanism for initial public offerings (IPOs).
- 1.2 This paper is intended to generate discussion and obtain feedback from the public on the proposed regulatory framework.
- 1.3 The proposal sets out to introduce two features in the fund raising process, namely, the over-allotment option and the price stabilization mechanism. The over-allotment option is the grant of an option by the issuer to the underwriter to over-allot shares in an IPO in excess of the number of shares constituting the original offer size. This gives the flexibility to the issuer to issue an additional percentage of shares and to the underwriter, the ability to satisfy last minute demand on those shares.
- 1.4 The price stabilization mechanism represents the second part of the process. This is intended to provide a support system on the first few weeks of trading whereby the underwriters of newly issued securities may conduct stabilizing actions to prevent the decline of the price of the newly issued securities.
- 1.5 The SC hopes that the responses to this paper will assist it in formulating a robust regulatory framework that would support the continued growth of a vibrant and competitive capital market.

2. Over-allotment option and Price stabilization mechanism

Objective

- 2.1 The main objective of a price stabilization mechanism is to enhance confidence in the market for newly issued shares. This is achieved through the ability of the underwriter to absorb the increase in supply of the newly issued securities and the short-term downward pressure that may accompany the excess supply. Investors will be aware that the additional supply of the newly issued securities would not artificially deflate the price. Issuers on the other hand, would be more inclined to issue more shares where the additional shares issued do not lead to downward pressure on the shares.

3. Current Legislative framework

- 3.1 A price stabilization mechanism enables the underwriter to continuously purchase the shares issued in an IPO in order to negate any downward pressure to the

- price of the securities. Such an act may fall within the prohibition of creating a false and misleading appearance of active trading (section 84 of the Securities Industry Act 1983 (SIA)) as well as that of market manipulation (section 85 of the SIA).
- 3.2 In addition to this, the option offered for the purposes of over-allotment effectively allows the underwriter to over-allot securities creating a short position in the shares issued which is prohibited under section 41 of the SIA.
- 3.3 Another element that is important in this process is the securities borrowing process. Currently, the borrowing of shares is only allowed pursuant to the Securities Borrowing and Lending Guidelines issued by the SC on 27 December 2006 whereby securities borrowing and lending transactions have to be made through the Central Lending Agency (CLA). However, in a price stabilization framework, this CLA model would not be applicable as borrowings would be made prior to the IPO for a very limited time and for a specific purpose. Here, the underwriter will enter into a securities loan arrangement before the IPO to borrow securities up to the size of the over-allotment option from the issuer or a third party. Such a securities loan arrangement permits the underwriter to deliver the over-allotted securities to the subscribers, upon closing of the issue. At the end of the stabilization period, the underwriter may satisfy its obligations under the securities loan arrangement either with securities purchased on the market through stabilization bids, by exercising the over-allotment option, or a combination of the two.
- 3.4 The SC is of the opinion that, in order to facilitate an effective price stabilization mechanism, an exemption from these provisions is required. In order to allow for such an exemption to operate, appropriate safeguards must be introduced to ensure that the operation of price stabilization mechanism would not compromise investor protection and the fair and orderly trading in the securities concerned.
- 3.5 It is therefore proposed that the price stabilization mechanism be introduced through Regulations issued by the Minister pursuant to section 87B of the SIA.
- 3.6 The proposed Regulations will provide for the matters below.
- (a) Pre-condition to stabilization – includes minimum issue size, disclosures in the prospectus, maximum size of the over-allotment option relative to the shares issued, name of underwriter conducting stabilization and the maximum period of stabilization.
 - (b) Conditions during stabilization – maximum price limit for stabilization, disclosure of stabilization action through the stock exchange.
 - (c) Post-stabilization period – register of full stabilizing actions conducted during the stabilization period.

4. Issues for consultation

4.1 *Applicability of price stabilization mechanism*

Given that the issues concerning demand for securities and price fluctuations are during the period immediately following an offer of securities are related primarily to newly issued shares, it is proposed that the over-allotment and price stabilization be limited to IPO situations.

4.2 *Size of Offer*

It is proposed that this mechanism be limited to IPOs with a size of above RM150 million or more. The threshold is proposed based on the experiences of overseas markets. A sizeable threshold ensures that the offer of securities is sufficiently large and broadly distributed to justify stabilizing action being carried out. Countries such as the UK, Hong Kong and Australia impose size thresholds under their price stabilization rules.

- **It is proposed that the application of the over-allotment option and price stabilisation mechanism is only for IPOs for the listing of shares on Bursa Malaysia's Main Board.**
- **It is proposed that the minimum size of the IPO be at RM150 million (the total issue multiply the IPO institutional price).**

The views of the public are sought on these issues.

4.3 *Size of over-allotment*

The size of the over-allotment granted by the issuer to the underwriter should be limited to fixed percentage over and above the number of securities issued in the IPO. Common practice in other jurisdictions is that the amount is fixed at 15% of the number of securities issued in the IPO.

- **It is proposed that the maximum size of the over-allotment option should be limited to 15% of the size of the IPO.**

The views of the public are sought on this issue.

4.4 *Disclosure*

An important feature of price stabilization is the need to disclose to the public the possibility that the underwriter may stabilize the price of the shares during the limited period following the IPO. This is to ensure that the investors are aware of the possibility of the stabilizing action by the issuer and the impact that these actions may have on the price of the securities concerned. Therefore, it is proposed that the disclosure be made on three occasions:

- In the prospectus, indicating to prospective investors of the possibility of the underwriter to over-allot and stabilize the price of the shares;
- For the underwriter to disclose at the end of the business day of any stabilizing action taken on that particular day; and
- At the end of the stabilizing period, a full disclosure of the over-allotment option taken and a list of the stabilizing action taken.

- **It is proposed that a requirement be imposed on the issuer to disclose in the prospectus of the granting of an over-allotment option and the possibility of the underwriter to stabilize the price; and**
- **The underwriter be required to do a daily disclosure and final disclosure at the end of the stabilizing period.**

The views of the public are sought on these issues.

4.5 *Maximum stabilization price*

As the objective of the stabilization action is to prevent a decline in the prices of the securities, the intervention allowed is to provide a floor to the price of the securities. In most jurisdictions therefore, the price limits for stabilization are broadly limited to a price at or below the issue price and in any event at or below the last stabilizing bid unless there has been an independent on-exchange transaction at a higher price since then. In general, it is permitted to maintain but not increase artificially the price of securities.

- **It is proposed that the stabilizing bids may be executed at or below the issue price (institutional price) or at or below the last stabilizing bid.**

The view of the public are sought on this issue.

4.6 *Time period for stabilization*

Current practices in other jurisdictions indicate a limit on the time frame during which an underwriter may stabilize the price of the securities. This period is usually 30 calendar days from the first day of trading of the shares. The rationale is that this period of time would be the most sensitive period post listing during which there would be a higher degree of uncertainty as to the market price of such securities.

- **It is proposed that the time period for stabilization be limited to 30 calendar days from the date of commencement of trading.**

The views of the public are sought on this issue

Conclusion

To date, the SC has carried out consultations on the proposed framework with the relevant industry associations including the Malaysian Investment Banking Association (MIBA) and Association of Stockbroking Companies Malaysia (ASCM). The public is invited to furnish us with their comments on the proposals set out in this paper.

APPENDIX

Practices in other jurisdiction

- 1 The over-allotment option is commonly known as the “Green shoe” option because it was first used in the offering stock by The Green Shoe Manufacturing Company in the United States in 1963. In this offer, underwriters were given an option to purchase a further block of shares over and above the initial offering for the purpose of “covering any short position which may be incurred in the initial distribution”.
- 2 As the over-allotment option encourages new issues and the raising of capital, this feature has been adopted in jurisdictions such as the United States, United Kingdom, Australia, India, Singapore, Hong Kong and Thailand.
- 3 A common feature of price stabilization regulations in most jurisdictions is to provide for a “safe harbour” to the market manipulation and insider dealing offences in order to allow the lead underwriter to be able to either purchase the shares in the open market when the prices are low or to be able to exercise the over-allotment option at the issue price if the prices traded in the open market are higher than the issue price. In Australia, however, this is done by the issuance of a no-action letter.
- 4 Generally the practices relating to over-allotment option are similar in most jurisdictions and would include areas below (see Appendix for comparison among the leading jurisdictions).
 - (a) Minimum value – Some jurisdictions e.g. United Kingdom, Singapore and Hong Kong impose a minimum value for the securities offered in order for the issuer to be eligible for the price stabilization mechanism. This is because sizable issues are seen to be more prone to price volatility during the initial period.
 - (b) Over-allotment amount – Most jurisdictions allow for an over-allotment of not more than 15% of the total offering (Singapore 20%). The cap on the over-allotment option is necessary in order to prevent the price of the issue from falling as a result of an increase in supply of securities issued.
 - (c) Disclosure requirements – Disclosure is an important element in the price stabilization mechanism in order to prevent market manipulation. Disclosure takes place in the situations below.
 - (i) Pre issue – All jurisdictions require disclosure of the over-allotment option be made in the prospectus in order to alert the investing public of the proposed price stabilization action.

- (ii) Commencement of stabilizing period – When there is an over-allotment of the securities, a public announcement is required to be made through the securities exchange relating to the stabilizing action that may be undertaken, maximum period of stabilization and the total value of the securities that the stabilizing manager may buy to undertake stabilizing action (Singapore and Hong Kong).
 - (iii) During stabilization period – It is a common practice for the stabilizing manager to disclose the number of securities traded for the purposes of the stabilizing action. However, the manner of disclosure differs from daily disclosure (Singapore, Hong Kong & Australia) to deferred disclosure (United Kingdom, within seven days).
 - (iv) Post-stabilization period – All jurisdictions require the public disclosure of particulars of the stabilizing actions undertaken which includes whether or not stabilization actions were undertaken and the dates of stabilization. The timing of the disclosure differs from the day after (Singapore) to within one week after the end of stabilization period (United Kingdom, Hong Kong).
- (d) Stabilization price – It is common in these jurisdictions, apart from United Kingdom, that the stabilizing action is limited by an intervention of an independent party in the market. Such an intervention automatically indicates the market demand for such shares and that the underwriter would be required to stop putting upward pressure to the price. In the United Kingdom, recent changes in the regulation allow the underwriter to continue its interventions as long as it is below the IPO price.
- (e) Register of stabilizing actions – The stabilizing manager is required to keep a register of stabilizing actions of all stabilizing activities undertaken. This requirement also applies to cases where the securities are listed in an overseas exchange.

Overall view of jurisdictional comparison:

Particulars	UK	Singapore	Hong Kong
Limitation for application (value) - This sets the minimum value of securities offered.	> GBP15 million	> SGD\$25million	> HK\$100 million
Limitation for over-allotment	Greenshoe option \leq 15% of the original offer; \leq 5% to each party	Greenshoe option \leq 20% of the original offer	Greenshoe option \leq 15% of the original offer
Stabilizing period	30 days Note: 30 days after closing of the IPO or 60 days after allotment	30 days	30 days
Disclosure	Not later than end of the 7th day following the transactions	The day immediately after the transaction	Register kept by stabilizing manager