

8 November 2023

## **Circular to licensed corporations on prudent risk management in providing IPO subscription services**

The Securities and Futures Commission (SFC) reminds licensed corporations (LCs) to prudently manage their risks in providing initial public offering (IPO) subscription services and financing to clients with the launch of the Fast Interface for New Issuance (FINI)<sup>1</sup>.

To streamline and digitalise the IPO settlement process in Hong Kong, HKEX will launch FINI on 22 November 2023. The pre-funding mechanism for public offer tranches will be modified<sup>2</sup> under FINI.

Notwithstanding the modification of the pre-funding mechanism under FINI, LCs should exercise prudent risk management and controls<sup>3</sup> when providing IPO subscription and financing services to clients. They should put effective measures in place to guard against any improper risk-taking activities, such as accepting large subscription orders without collecting sufficient subscription deposits<sup>4</sup> from clients upfront or providing excessive IPO financing to clients. In particular, related measures should cover the following areas:

### *Prudent credit risk management*

- Ensure that clients have sufficient financial resources to settle obligations related to their IPO subscriptions in full before accepting their orders. Where appropriate, impose upfront subscription deposit requirements on non-fully funded IPO subscription orders
- Formulate a prudent credit policy for IPO financing and set appropriate credit limits for clients by taking into account the financial capability of the firm, the financial circumstances of the clients, the size of and demand for the IPOs and the prevailing market conditions
- Properly justify any deviation from the credit policy and credit limits with a written risk assessment and obtain senior management's approval for the deviation

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<sup>1</sup> Hong Kong Exchanges and Clearing Limited (HKEX) published relevant information about FINI on its [FINI Webpage](#), including the [Concept Paper Conclusions](#), [FINI Information Pack](#), [FINI Transition Arrangements Guide](#), [User Guide for HKSCC Participants](#) and [Terms and Conditions of FINI](#).

<sup>2</sup> Contrary to the existing practice of full payment of subscription amounts prior to pricing and balloting, a clearing participant under FINI will have to arrange its designated bank to confirm the availability of funding for settlement of its subscriptions without actual fund transfer to the issuer until after pricing and balloting. If the clearing participant opts in for a compressed pre-funding mechanism available under FINI, the pre-funding amount to be confirmed by its designated bank will be capped at the highest value of shares that the issuer is able to allocate to a public offer tranche.

<sup>3</sup> General Principle 3 and paragraph 4.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC and Part VIII of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC.

<sup>4</sup> Including the subscription money paid by a client to the firm and the available cash balance in the client's account maintained with the firm.

### *Liquidity risk management and safeguarding client subscription deposits*

- Prepare sufficient cash or credit facilities with banks for IPO money settlement; settlement defaults by clearing participants may be subject to HKEX's punitive actions<sup>5</sup>
- Ensure that house money or credit facilities are sufficient to finance clients where the value of shares allotted to them exceeds the amount of subscription deposits they provided to the firm
- Adequately safeguard clients' subscription deposits by keeping in the firm's segregated bank accounts those subscription deposits which are not placed with designated banks for pre-funding confirmation purpose<sup>6</sup>

### *Financial risk management*

- Avoid excessive bank borrowings and granting IPO financing to clients beyond the firm's financial capability
- Properly account for all assets and liabilities arising in the IPO subscription and settlement cycle in accordance with generally accepted accounting principles; seek professional advice on appropriate accounting treatment where necessary<sup>7</sup>
- Critically assess the potential impact of IPO financing on the firm's liquid capital position computed in accordance with relevant provisions under the Securities and Futures (Financial Resources) Rules (FRR), including:
  - Only include any amount receivable from a client for an IPO subscription in liquid assets up to 90% of the total subscription costs to the client<sup>8</sup>
  - Include on-balance sheet liabilities (such as any outstanding bank loans or settlement liabilities) arising in the IPO subscription and settlement cycle in adjusted liabilities of the firm for the purpose of calculating its variable required liquid capital<sup>9</sup>

Senior management of LCs bear primary responsibility to ensure proper risk management for their firms. They should implement proper risk management policies and control procedures having regard to the areas mentioned in this circular.

Should you have any queries regarding this circular, please contact your case officer.

Intermediaries Supervision Department  
Intermediaries Division  
Securities and Futures Commission

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<sup>5</sup> Paragraph 61 of the [Concept Paper Conclusions](#).

<sup>6</sup> General Principle 8 and paragraph 11.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC.

<sup>7</sup> Including consulting professional accountants and making reference to any guidance issued by the Hong Kong Institute of Certified Public Accountants.

<sup>8</sup> Section 21(5) of the FRR.

<sup>9</sup> *Adjusted liabilities* is defined in section 2(1) of the FRR.