

Cornerstone Investors in an IPO

by Ong Eu Jin and Eileen Tan Yuh Wen

In an initial public offering (IPO), cornerstone investors are typically approached at an early stage (before the management roadshow and book-building exercise) who will agree in advance to subscribe to a fixed number of IPO shares in the issuer. They will be guaranteed an allocation of the IPO shares that may otherwise be scaled back in case of an oversubscription or under clawback provisions that allow for re-allocation between the tranches institutional offering and retail offering (or in other jurisdictions, the placement and public tranches) in the event of over-demand in one tranche and under-demand in the other.

Cornerstone investment helps to de-risk the equity transactions for issuers and underwriters by having a significant proportion of the IPO shares already subscribed at the outset of the marketing process.¹ By guaranteeing that a proportion of the deal will be sold, the investment banks have less to sell, which clearly assists the success rate of an IPO (especially one that is sizeable) in challenging market conditions.²

As parties who become cornerstone investors are generally well-known in the market, their investment encourages other market participants (particularly retail investors who will not have the same knowledge and resources to assess the potential value of investments) to invest in the IPO shares.

There are many types of cornerstone investors in Asian IPOs, including wealth funds, high net worth individuals, insurance companies, pension funds, social security organisations, charities and similar institutions, asset managers and some corporate investors. Some examples of parties that have participated as cornerstone investors in Malaysian IPOs are the Employees Provident Fund, Kumpulan Wang Persaraan (Diperbadankan) (also known as KWAP), Lembaga Tabung Haji and Permodalan Nasional Berhad.

Cornerstone investors have increasingly become commonplace in Asian IPOs, particularly in the Hong Kong, Singapore and Malaysia markets. Hong Kong has what is considered to be a more comprehensive and restrictive regulatory regime, while Malaysia and Singapore are generally considered more flexible.

Legal framework

Underwriting

In Hong Kong, subscriptions by cornerstone investors are part of the placement tranche, and there is therefore a *de facto* requirement for cornerstone offerings to be underwritten.³ In Malaysia or Singapore, however, cornerstone tranches are not required to be underwritten.

Disclosure requirements

Prospectuses for IPOs in Hong Kong must include a specific section on the cornerstone tranche with information on:

- (a) The identity of each cornerstone investor;

¹ Philippe Espinasse, *Cornerstone Investors: A Practice Guide for Asian IPOs* (Hong Kong University Press, 2018), Chapter 1.8

² Tze-Gay Tan and Jeanne Ong, "Cornerstone investors in IPOs—an Asian perspective", *Capital Markets Law Journal* (Volume 8, Issue 4, October 2013), at pp 427–449

³ *Supra n 1*, Chapter 2.1

- (b) The amount subscribed by each cornerstone investor, as well as the percentage of shareholding it represents (both pre and post-exercise of the overallotment option, if any); and
- (c) The independence of each cornerstone investor.

In Malaysia, the prospectus guidelines issued by the Securities Commission (SC) requires information relating to cornerstone investors and any lock-up arrangements to be disclosed.

Paragraph 3.01 of the Prospectus Guidelines issued by the SC provides that:

“Details of the shares being issued or offered must be disclosed, including the following:

- (a) The number of shares proposed to be issued or offered to different groups of investors;
- (b) If, in conjunction with the offering, shares of the same or another class are sold or subscribed privately, *the nature of such sales or subscriptions and the number and characteristics of the issues concerned, including details of underwriting or undertaking arrangements*; and
- (c) If there are other securities issued or offered in conjunction with the offering, details of such securities must be disclosed.” (*Emphasis added*)

Paragraph 3.03 requires the further disclosure of:

“Details about the pricing of shares, including —

- (a) the price offered to each class of investors and where applicable, the minimum and maximum offer price; and
- (b) the basis for determining the offer price.”

While, as with Hong Kong, the cornerstone subscription agreements are considered material contracts and the terms must therefore be disclosed in the prospectus and made available for inspection by the public,⁴ in Malaysia, individual subscriptions by cornerstone investors are generally not stated, and only the aggregate amount subscribed by all the cornerstone investors is disclosed.

Lock-up arrangements

In Hong Kong, cornerstone investors are subject to a customary lock-up for a minimum of six months after the listing date, although it should be noted that, rather than being imposed by the Listing Rules, this is a contractual arrangement with the issuer and the underwriters and that, as such, it can be waived (although in practice rarely) by the lead banks.⁵

Similarly, although there is no requirement for any lock-up arrangements for cornerstone investors in Malaysia, it exists as a matter of practice.

⁴ *Supra n 1*, Chapter 2.1.5

⁵ *Ibid*, Chapter 2.1.2

Lock-up arrangements and their disclosure can provide confidence to potential investors in an IPO by showing that the cornerstone investors will not dispose of their shares soon after listing.

However, some commentators have argued that lock-ups create an “overhang” of shares in the market, which not only reduces trading liquidity but also depresses the share price of the company near the expiry of the lock-up.⁶ Perhaps, coming six months after the initial listing, this effect on the market is more acceptable.

‘Double-dipping’

In Hong Kong, cornerstone investors (and related parties) must not place orders in the institutional book of demand on top of, or in addition to, their guaranteed allocations. This is to prevent offering of shares on a preferential basis.⁷ There is no such prohibition in Malaysia.

Transaction documents

Non-disclosure agreement

Cornerstone investors will be asked to sign a non-disclosure agreement before the issuer and bookrunners make their presentation to the investors, for any information, which is non-public, confidential or proprietary in nature that may be disclosed to the investors.

Subscription agreement

The cornerstone subscription agreement (sometimes also called the individual cornerstone placement agreement) will be signed before the start of the book-building process and tie the cornerstone investor down, subject only to certain conditions precedent, which typically would include the following:

- The underwriting agreement and placement agreement being entered into
- The SC having approved the IPO and Bursa Malaysia having approved the listing of the IPO shares
- The registration of the prospectus with the SC.

Master subscription agreement

In addition to the individual subscription agreement, a master cornerstone agreement will be entered into by the cornerstone investors, the issuer and bookrunners, and the global co-ordinator (in the case of a global offering), which would set out the allocation of IPO shares to each cornerstone investor. In a Malaysian IPO, this document (rather than the individual subscription agreement) would be made available for public inspection.

6 *Id*, Chapter 4.4
 7 *Id*, Chapter 2.1.4

Conclusion

There have been questions of fairness on cornerstone investors having “first dibs” at IPO shares. Commentators have also regularly picked up on the issue with talk of an inside game and of unfair behaviour.⁸

Notwithstanding that, cornerstone investors have proven critical to the success of Asian IPOs.

The Stock Exchange of Hong Kong Limited (SEHK) has expressly taken a more proactive stance in policing equality of treatment issues arising from the cornerstone process, and has been keen to emphasise that aside from guaranteed allocation, there should be no other direct or indirect benefits to cornerstone investors. The question arises whether a more overt stance by Malaysian regulators on these issues will make for a healthier market.

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About the authors

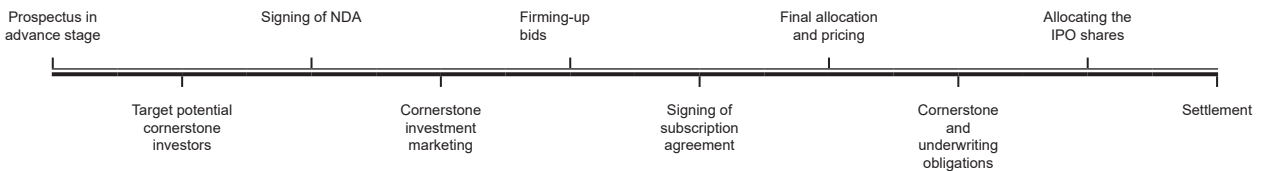


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Cornerstone Investment Process



⁸ Philippe Espinasse, “Cornerstone investors and ethics”, *Wall Street Journal*, 22 December 2010