



Supervisory Policy Manual

CR-L-4

**Underwriting of Securities:
§§81 and 87**

V.1 - 31.08.01

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To explain the MA's policy towards the underwriting and sub-underwriting of securities by AIs in relation to §§81 and 87 of the Banking Ordinance

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline 5.2.4 "Underwriting of Securities: §§81 and 87" dated 13.10.91

Application

To all locally incorporated AIs

Structure

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1. Statutory position

1.1 §81 - Limitations on advances by AIs

- 1.1.1 §81 limits a locally incorporated AI's aggregate financial exposures to a single party or group of related parties to 25% of its capital base. Aggregate financial exposures include the value of an AI's holdings of shares, debentures and other debt securities issued by these parties (see subsection 2.3 of [CR-G-8](#) "Large Exposures and Risk Concentrations").
- 1.1.2 Among the exemptions available under §81, §81(6)(i) provides that any on-balance sheet exposures acquired under an underwriting or sub-underwriting contract can be excluded, for up to seven working days, from calculation of an AI's exposure for the purposes of the 25% limit. The MA may give written approval for longer periods and, if the MA thinks proper, attach conditions to such approval.
- 1.1.3 §81(6)(j) further provides for the exemption of off-balance sheet exposures acquired under an underwriting or sub-underwriting contract from the 25% limit.



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1.2 §87 - Limitation on shareholding by AIs

1.2.1 §87 provides that a locally incorporated AI should not acquire or hold share capital in other companies to an aggregate value exceeding 25% of its capital base.

1.2.2 An exemption from §87 similar to that of §81(6)(i) is available under §87(2)(a) (see para. 1.1.2 above).

1.3 Seven day exemption period

1.3.1 The seven day exemption period available under §§81 and 87 runs from the time when an AI acquires the shares being underwritten.

1.3.2 The main reasons for the short exemption period are to make the HKMA aware of an exposure at an early stage and to deter AIs from taking on too large underwriting commitments with which they may not have the necessary experience, skills and systems in place to deal.

1.3.3 The MA has discretion to extend the exemption period from the limitations in §§81 and 87 beyond seven working days.

2. Supervisory approach

2.1 Rationale

2.1.1 The HKMA needs to be satisfied with the nature and scale of any prospective underwriting transactions before an AI enters into a commitment. It does so by adopting the policy set out in this module. This seeks to avoid the situation in which an AI is left with an imprudently large exposure at the end of the seven day exemption period in circumstances where the MA is not content to extend the exemption period.

2.2 Coverage

2.2.1 The HKMA's policy covers underwriting and sub-underwriting commitments in respect of new securities and further issues of existing securities, where the AI will only be



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called upon to purchase the securities if end-investors fail to do so.

- 2.2.2 It does not cover “bought deals” where the AI acquires the securities from the outset as a principal for subsequent sale in the market or “block trades” in the secondary market. Holdings of securities in these circumstances will form part of a financial exposure covered by §81 and a holding of share capital under §87 if the securities in question are shares.

3. Prior consultation on underwriting activity

3.1 Underwriting policy

- 3.1.1 Any AI wishing to engage in underwriting activity should first agree its plans with the HKMA.
- 3.1.2 This will require the AI to prepare an underwriting policy, agree it with the HKMA and have it finally approved by its Board of Directors. The policy will need to contain, inter alia;
- approved types of underwriting transactions;
 - individual and aggregate limits applying to underwriting commitments. Such limits should also take account of cases where the AI has other financial exposures to the counterparty concerned;
 - where no such limits are in place but transactions are to be approved case by case, clear instructions about the type and size of transactions which will be contemplated;
 - arrangements applying to the sub-underwriting of commitments taken on by the AI, including the degree of commitment which should be obtained from the sub-underwriter; and
 - arrangements for the disposal of securities acquired under an underwriting contract, in particular to avoid



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a financial exposure exceeding 25% of capital base after the exemption period.

3.2 Maximum permitted commitments

- 3.2.1 The HKMA will agree with an AI in advance the maximum size and type of underwriting and sub-underwriting transactions, measured on an aggregate basis per issuer, that it can take on. AIs may also establish limits for different categories of issuers, e.g. according to their credit ratings.
- 3.2.2 The limits will apply to the maximum amount of securities an AI is committed to taking up, i.e. after deduction of amounts to be sub-underwritten by other parties under firm and binding agreements.
- 3.2.3 In considering the limits proposed by an AI, the HKMA will take account of the following factors:
- the AI's underwriting policy;
 - types of securities to be underwritten - for example, the limits should reflect the relative risks of different types of securities and issuers (with reference to their credit ratings where applicable);
 - the AI's underwriting expertise and previous experience and track record (e.g. whether it has been "stuck" with any issues);
 - the AI's market standing, placing network, etc; and
 - risk control systems in place.
- 3.2.4 Prior consultation with the HKMA will be necessary, however, where the AI already has a financial exposure to the issuer concerned, including in respect of other underwriting commitments. The maximum allowable size of an underwriting transaction may need to be reduced to take account of this exposure.



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4. Notification and other requirements

4.1 Notification

4.1.1 Depending on the size of the limits agreed, the HKMA may set a notification threshold below the maximum limit, so that it is made aware of significant commitments being undertaken.

4.2 Requests for extension of exemption period

4.2.1 Where an AI applies for the MA's consent to hold securities beyond the seven day exemption period, the MA will give such consent for a period of up to three months, provided that the underwriting commitment falls within a previously agreed limit as mentioned in subsection 3.2.

4.2.2 A further extension of the exemption period, however, will only be granted in special circumstances.

4.3 Commitment in excess of previously agreed limit

4.3.1 Where a proposed transaction would exceed a previously agreed limit, the AI should seek the prior approval of the HKMA.

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