

FSC UNVEILS MEASURES TO IMPROVE THE SOUNDNESS OF IPO MARKET

The FSC unveiled measures to bolster the soundness of the initial public offering (IPO) market. The key measures include (a) allowing bookrunners to “test the waters” through demand survey to determine an appropriate price band of an IPO, (b) making bookrunners check institutional investors’ abilities to pay for stocks under their responsibility and, after that, accept subscriptions and carry out allotment of shares, and (c) increasing the limit range of the quotation price on the day of IPO to promote formation of an equilibrium price early on.

BACKGROUND

An initial public offering (IPO) is a gateway for unlisted firms going public as well as an essential mechanism in capital markets. In this regard, it is important to make sure that price discovery function in public offering markets works properly and enables investors to make stable investments at fair value. Although the recent IPO market boom has somewhat subsided, the following behaviors that threaten a sound order in the market still exist. First, it can be challenging to determine the right price band for an IPO because assessing how market demand will change as an IPO price shifts remains difficult. Second, at the subscription stage, investors subscribe in shares which far exceed the actual demand to secure the portion of shares they hope to get allocated. Such actions set up a vicious cycle where investors fictitiously oversubscribe, resulting in excessive competition, which in turn leads to oversubscription. Third, after going public, there are worries about harm to investors from the phenomenon where stock quotation prices immediately reach the upper limit price on the first day or on the first and second days of an IPO, causing a situation of de facto transaction halt, and then collapse. Against this backdrop, in order to ensure that the IPO market can serve its original goal of helping unlisted firms’ entry into public offering markets and to promote the development of the IPO market based on more fairness and soundness, authorities have prepared the following measures for improvement after having discussions with experts and relevant stakeholders on numerous occasions.

KEY DETAILS

- a) **(BOOK BUILDING)** Authorities will substantialize the book building in order to ensure that the price band of an IPO is set reasonably.
- Bookrunners will be permitted to preliminarily review institutional investor demands even before submitting a securities registration statement, allowing them to reasonably reevaluate and adjust the price band of an IPO (Revision of FSCMA1 Required).

- To help better selection of an appropriate offering price within the price band, the book building period that is currently completed for two days will be extended, for example, to seven days.

b) **(SUBSCRIPTION AND ALLOCATION)** Authorities will enhance bookrunners' responsibility for their management of fictitious oversubscription while, to the greatest extent possible, respecting their autonomy. *(Revision of regulation on financial investment businesses and industry group regulation expected in April 2023)*

- Bookrunners will develop their own criteria for evaluating institutional investors' capacity to make stock purchases and will be required to allocate shares only after evaluating institutional investors' capacity to make stock purchases. For bookrunners that are found to have been negligent about this duty, authorities will establish a legal basis for punishment, such as suspension of business, through an inspection by the Financial Supervisory Service. In addition, for institutional investors that are found to have committed a fictitious oversubscription, authorities will empower bookrunners to issue penalties such as a considerable downsizing in share allocation, restriction from participating in book building, and etc.
- In addition, authorities will strengthen the price discovery function of book building by restricting allocation of public offering shares to the institutional investors that have failed to state their bidding prices at the book building stage.

c) **(PREVENTION OF EXCESSIVE STOCK PRICE SWING)** Authorities will continuously make efforts to prevent excessive price swings of public offering shares in order to minimize damages to investors stemming from a delay in the discovery of an equilibrium price and short-term price swings and etc. after the IPO.

- Authorities will establish practices regarding IPO lock-ups. Bookrunners will be required to differentially allocate shares in accordance with the required holding period of the lock-up agreements in order to prevent a large-scale unloading of public offering shares all at once, either right after the IPO or after the lock-up period. *(Revision of industry group regulation expected in April 2023)*
- In addition, authorities will raise the limit range of the quotation price on the day of IPO to 60~400 percent of the public offering price, which is selected after a review of cases in other countries, in order to prevent oligopoly of trading opportunities by a few and a delay in discovering an equilibrium price. ¹ *(Implementation expected in H1 2023 after development)*
- To prevent institutional investors from indulging in overheated speculation, authorities will consider developing a tracing system for an "IPO short-term gain trading." The system will be designed to keep the sales transactions of institutional investors who have not agreed to lock-up periods and to have their records reflected in future allocations of public offering shares. Early in 2023, a taskforce made up of

¹ Current limit range of the quotation price on the day of IPO is 63~260 percent of public offering price. (The opening price is determined between 90 and 200 percent of public offering price and the limit range of the quotation price is $\pm 30\%$ of the opening price.)

representatives from the industry and pertinent institutions will be established. This taskforce will commission a study to determine whether it is feasible to introduce this system within the following year and to develop detailed plans.

ANTICIPATED EFFECT

Authorities expect that these measures will help build a foundation where the prices of public offering shares are calculated more reasonably and investors are allocated with shares according to their real demand and payment capacity. For businesses, appropriate evaluation based on their actual future value will enable blue-chip companies to sufficiently raise funds needed. For institutional investors, these measures will offer fair opportunities based on their real demand and payment capacity, while enabling them to invest in the stable and long-term manner. For bookrunners, the measures will provide opportunities to develop differentiated capacities as they play a bigger role in book building activities and discovery of appropriate prices for public offering shares, reviewing and determining investors' capabilities. In the long term, the measures will also boost their capacities as investment banks.

FURTHER PLAN

Authorities plan to complete the regulatory revision process in the first half of 2023 and continue to operate a taskforce comprised of relevant authorities and industry officials to bring about improvements to IPO market practices and develop relevant infrastructures needed to make improvements.

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For press inquiry, please contact Foreign Media Relations at fsc_media@korea.kr.