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31st July, 2003

Hong Kong Exchanges and Clearing Limited
Listing Division
11th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

By facsimile (2295 3599) and by hand

073382

The Securities and Futures Commission
The Corporate Finance Division
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

By facsimile (2810 5385) and by hand

Consultation Paper ("Consultation Paper") on the Regulation of Sponsors and Independent Financial Advisers

Dear Sirs,

In light of a number of corporate scandals and unheralded failures involving Hong Kong listed companies in recent years, we support the Exchange's view that there is a need to enhance the competence and standards of the professional intermediaries which are involved in the listing work in Hong Kong. We consider that such failures are due to different standards maintained by different professional intermediaries including sponsors (and financial advisers) and, based on our experience, this creates an uneven playing field for those sponsors who are devoting the nececessary resources and diligence to discharge their responsibilities properly and also leads to unfair competition on pricing in the market. Hence, we do agree with the Exchange that there is a need to help narrow the "expectation gap" concerning the responsibilities of sponsors (and financial advisers) between investors, regulators and some sponsors (and financial advisers) in order to enhance the quality of the Hong Kong listed companies.

Nevertheless, one should note that the success of a listing exercise relies not only on one professional party but each member of all professional teams as well as the listed company and its directors. Notwithstanding that the directors of the listed companies would be "coached" by the sponsors in relation to the Exchange Listing Rules and legal obligations to ensure that they appreciate their responsibilities and roles, and the sponsors (and financial advisers) would be regulated by the proposed Code of Conduct for Sponsors and Independent Financial Advisers ("Code of Conduct") and the revised Exchange Listing Rules as proposed in the Consultation Paper, other professional parties are also required to provide a higher standard of work in the process of bringing issuers to the market. Accordingly, although, it was stated in paragraph 194 of the Consultation Paper that "we do not propose changes to the Listing Rules affecting other profesional advisers involved in the listing process", we are of the view that the Exchange should work immediately with the governing bodies of other professionals regarding the regulation of their work during listing. The relevant revisions in the Exchange Listing Rules and the Code of Conduct should be effective simultaneously with these regulations on other professionals.

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

We would like to express our view in response to the Consultation Paper as follows:-

Q1. Acceptable sponsor firms

It is stated in the Consultation Paper that "the Exchange may refuse an application as a sponsor or cancel a sponsor's admission to the list if the Exchange considers that the sponsor or applicant does not satisfy the criteria established in order for the firm to be included on the list of acceptable sponsors maintained by the Exchange". On one hand, we consider that a list of acceptable sponsor firms to be maintained by the Exchange is acceptable. On the other hand, we suggest that (i) those sponsors whose applications to the list of acceptable sponsors maintained by the Exchange have been rejected or whose admissions have been cancelled should be provided with the detailed reasons therefor; and (ii) there should be a clear and proper appeal mechanism discloseable to the public in this regard.

Q2. Acceptable IFA firms

Similar to our view for acceptable sponsor firms above, although we consider that a list of acceptable IFA firms to be maintained by the Exchange is acceptable, we also suggest that (i) those IFAs whose applications to the list of acceptable IFAs have been rejected or whose admissions have been cancelled should be provided with the detailed reasons therefor; and (ii) there should be a clear and proper appeal mechanism discloseable to the public in this regard.

Q3. Acceptable individuals

We in principle agree with the criteria (a) and (b) for the acceptable individuals that the individuals are appropriately licensed/ registered under the SFO; and work for a sponsor firm or IFA firm (whichever is applicable) and are eligible supervisors or perform work under the supervision of an eligible supervisor. **However, we have grave reservation on the criteria (c) that the individuals are not on the list of unacceptable individuals as we do not agree to maintain a public list of unacceptable individuals.**

As stated in paragraph 54 of the Consultation Paper, the Exchange will maintain a list of unacceptable individuals, that is a list of individuals who are not permitted to perform sponsor or IFA work and the list of unacceptable individuals will be made public on the HKEx website. We anticipate that it would create certain problems as discussed below.

Firstly, we consider that the main purpose of the unacceptable list is to disqualify an individual who does not meet the criteria for inclusion on the list of sponsors and IFAs due to material breach of the Listing Rules or other factors. As such, we suggest that it would be more appropriate for the Exchange to establish an acceptable individual list in order to certify/confirm the persons who are qualified to perform such work. For those who do not meet the relevant criteria shall be removed from the list. We consider that establishing an acceptable individuals list is sufficient to serve the above-mentioned purpose and therefore, we do not consider that there is any need to maintain an unacceptable list.

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

Secondly, it has not been stated in the Consultation Paper how to determine and who has the authority to judge an individual to be unacceptable and whether there will be a clear and proper appeal mechanism should an individual be regarded as an unacceptable individual. Should this proposed unacceptable list be adopted, clear and absolute objective conditions should be built in so as to remove any possibilities of subjective judgement. Otherwise, the market would be concerned of the issue of possible abuse of such discretionary power. Therefore, we consider that this proposed unacceptable list would create problems, concerns and confusion in the market.

Thirdly, it is stated in paragraph 63 of the Consultation Paper that the focus of requirements should place greater weight on experience of professional staff, rather than the sponsor firm itself and the Exchange agreed. In case there is an unacceptable individuals list published on HKEx website, not only such individual is not permitted to perform sponsor or IFA work, the image of the unacceptable individual's employer and its business will be adversely affected.

Last but not the least, ruling an individual as "unacceptable" may be perceived as ruling that individual as "guilty", which may have a negative labelling effect witihn the society on that individual. Consequently, a list of unacceptable individuals to be made public on the HKEx website may adversely affect the career of the individuals who may wish to switch to other fields after having been regarded as unacceptable individuals in the business of corporate finance by the Exchange. We consider such penalty by way of public disclosure for the unacceptable individuals would be too harsh and a time span of suspension should be set to allow such individuals to return to corporate finance business.

Therefore, the list of acceptable individuals with a set of proper removal criteria is already sufficient to serve the purpose.

Based on the above, we strongly suggest the Exchange to disclose only a list of acceptable individuals on the HKEx website and consult the public again as to the criteria for removing the corporate finance professionals from the acceptable individuals list.

Criteria for inclusion on the list of sponsor and IFA firms

Q4. Competence and experience of the sponsor and IFA firms

In light of the experience and structure of our existing staff, we have no objection as to the requirements of a sponsor firm to have at least four eligible supervisors and that of an IFA firm to have at least two eligible supervisors.

香港中環皇后大道中九十九號中環中心十二樓
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Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

Q5. Qualification and experience *criteria* of eligible *supervisors*

We basically agree with the four-year experience requirement for the four eligible supervisors required in each sponsor firm. **However, after attending the seminar held by the Exchange relating to the Consultation Paper, it seemed that the Exchange will only consider a straight four years of experience immediately preceding the application without any flexibility to look at experience beyond four years as presently practised in the GEM market.** Given the present Hong Kong economy, it is suggested to adopt a similar system as currently adopted by GEM that experience beyond four years shall be accountable.

While substantive involvement in IPOs can easily relate to the work of sponsors (and financial advisers), it is not stated in the Consultation Paper whose substantive involvement in the significant transactions shall be accountable as there are usually one financial adviser and one IFA for a transaction of either material or sensitive nature. **We consider that both financial advisers and IFAs' experience shall be accounted for substantive involvement in the significant transactions as the role of the financial advisers is mainly to conduct due diligence and advise the listed company the structure of the transaction and to coordinate with other professional parties and that of the IFAs is mainly to perform their due diligence work and advise the investing public through the independent board committee whether the interests of the investing public in the listed companies may be impaired and the terms of the transactions are fair and reasonable so far as their interests and that of the issuer are concerned.** As both roles of the financial advisers and the IFAs are important so far as the listed companies and the investing public are concerned, we consider that the experience of the financial advisers and the IFAs in significant transactions shall be regarded as substantive involvement in significant transactions.

As we are all aware, investors are in general sensitive to all kinds of connected transactions entered into between a listed company and a connected person and concern whether their interests in the listed companies may be impaired and the terms of the transactions are fair and reasonable so far as their interests and that of the company are concerned. In this regard, sponsors (and financial advisers) and IFAs are expected to exercise due care in advising both the listed companies and the investing public (through the independent board committee) the terms of the connected transactions. **We suggest that the definition of "significant transactions" should also include all kinds of connected transactions that require shareholders' approval.**

As regards the experience criteria for IFA firm, we agree that the eligible supervisors should have substantive involvement in at least three (3) significant transactions but we also suggest that one (1) of those three (3) transactions should be acting as an independent financial adviser in respect of the "significant transaction" in order to establish the relevance of the experience of the eligible supervisors.

香港中環皇后大道中九十九號中環中心十二樓
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Q6. Other factors relevant to the eligibility criteria

It is stated in paragraph 91 of the Consultation Paper that "the Exchange maintains the view that disclosure to the Exchange is necessary, as any past censorship or alternative regulatory action may raise doubts about the ability of a prospective sponsor or its employees to discharge their responsibilities effectively in respect of advising listing applicants and listed issuers on compliance with the Exchange Listing Rules". We suggest that the Exchange should only consider the censorships and discipinary actions relating to the corporate finance business and not those relating to the brokerage business, etc. when assessing the acceptability of sponsors and IFAs as there is normally a Chinese wall between the corporate finance unit and other departmental units within a sponsor firm. In addition, it is expected that the Exchange will have an objective assessment on prospective sponsors, provide reasons for those sponsor firms failing to admit to the acceptable list and allow a clear and proper appeal mechanism in this regard.

Q7. Minimum capital requirement of sponsor firms

We agree with the proposed capital requirement for sponsor firms of not less than HK$10 million, which is the same as that under the GEM Listing Rules and nil for IFA firms.

Q8. Undertakings to the Exchange

Although we do not have strong objection to providing an undertaking to the Exchange (it is stated in the Consultation Paper that the undertaking is relating to complying with the relevant Listing Rules applicable to sponsors or IFAs, including the proposed Code of Conduct, and to assist the Exchange with investigations, including by producing documents and answering questions fully and truthfully) for the application to be admitted to the sponsors list, it is suggested to have a standard form of undertakings for the prospective sponsors' signing to avoid administrative burden, which is similar to the current practice on GEM. Nevertheless, we are not aware that the GEM Listing Rules require the principal supervisors and the assistant supervisors to provide similar undertakings. It is suggested not to require the eligible supervisors to provide the same. It would be too harsh for the eligible supervisors to provide such undertaking as (i) eligible supervisors are only employees of the sponsor firm; and (ii) eligible supervisors can be removed from the acceptable list as a result of a material breach of the Lisitng Rules as sugested above; and (iii) it would be sufficient for the sponsor firm to give such undertaking and it is normally only the sponsor firms would have sufficient financial resources to make good the undertakings when damages or losses are claimed under such undertakings.

In addition, it is stated in paragraph 98 of the Consultation Paper that "we (the Exchange) are not proposing to continue the concept of co-sponsorship". We are aware that it is normally the commercial decision of the issuers to appoint more than one sponsor in respect of their listings on the Exchange and so far as all sponsors working on the transaction would be responsible for complying with the Code of Conduct and the Exchange Listing Rules requirements, we do not see the reasons why the concept of co-sponsorship (regardless the size of the IPO) shall not be continued.

香港中環皇后大道中九十九號中環中心十二樓
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Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

Q9. Appointment

We basically agree with the Exchange that newly listed issuers may require sponsors to provide continuous advice and training during the period of its initial listing (say, one year) with a view to complying with the Exchange Listing Rules as they may still be fresh to familiarise with the Exchange Listing Rules requirements and their legal obligations. In addition, we would suggest to incorporate it into the Exchange Listing Rules that the issuers should provide sufficient information on their businesses to allow the sponsor or IFA to perform its duties.

Q10. Independence

It is not stated in the Consultation Paper the definition of sponsor's group. We suggest that the sponsor's group shall only include (i) the sponsor, (ii) its holding company and subsidiaries (if any) held by the holding company and (iii) its subsidiaries, all of which are engaged in financial advisory, brokerage, commodities and futures trading, fund mangement and related businesses. As some sponsor firms may be under groups of companies which are engaged in other areas of businesses (such as property development, manufacturing, etc.), the proposed requirements under the Consultation Paper may be administrative burdensome and irrelevant for the sponsor firms to clarify its independence with the new applicant.

We note that paragraph 119 of the Consultation Paper saying that "where a director or employee (or their associates) of the sponsor has an interest in or business relationship with the new applicant" whereas the Summary of Question in Annex 3 to the Consultation Paper saying that "where a director or employee of the sponsor or a close family member of either a director or employee has an interest in or business relationship with the new applicant". We suggest to follow the latter that the "close family members" rather than "associates", and such "close family members" should be clearly defined in the Exchange Listing Rules for the avoidance of doubt. We would suggest that the underlined "employee" should only refer to those employees involved in the transaction as it would affect the confidentialty of the transaction if the sponsor firms are obliged to ask all employees within the firm in this regard. The sponsor firm/IFA firm is unable to comply with on one hand the requirement of Chinese Wall, i.e. keep confidentiality of price-sensitive information from others not involving in the transaction, and on the other hand the requirement of confirming with all employees with regard to their interest or business relationship with the new applicant/listed issuer. In addition, we consider that it would be too harsh if the directors of the sponsor firms (and their close relationship) cannot even hold any share in the new applicant and have business relationship with the new applicant. The Exchange may consider to adopt the practice that "business relationships with an issuer that could give the sponsor or another company in the sponsor group a material interest in the success of a transaction. For the avoidance of doubt, we suggest to provide quantitative requirements for the forgoing, say less than 5% interest in the new applicant (same as that for the sponsor firm) and less than 5% of the new applicant's turnover.

香港中環皇后大道中九十九號中環中心十二樓
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In respect of the IFAs' independence requirements, it is stated in the Consultation Paper that "the Exchange will generally preclude from concluding that an IFA is independent if it has served as a financial adviser to the relevant listed issuer, its subsidiaries or any of <u>its connected persons</u> any significant assignment within two years of appointment. **We suggest that the connected persons concerned (as underlined) shall only be those persons regarded as connected by virtue of their interests in such connected transaction.** With respect to business relationship with the issuer and its directors (for instance, holding securities accounts with the sponsor's group), we suggest that it would affect the IFA's independence only if it is in a material context and therefore, dormant and inactive securities accounts shall not be accountable. In addition, paragraph 49 of the Consultation Paper proposes that "when a sponsor or an IFA is appointed it must submit a confirmation of independence with any draft documentation submitted to the Exchange for review". To facilitate the provision of independence confirmation, the Exchange may consider that the independence requirements and a standard form should be provided in the Exchange Listing Rules. Alternatively, it is also suggested that the Exchange should send the sponsor or the IFA a formal letter stating clearly the aspects the Listing Division would like the sponsor or the IFA to confirm in respect of their independence to that transaction in order to enhance the efficiency and such formal letter should set out the criteria consistent with those in the Exchange Listing Rules.

Responsibilities

Q11. Reasonable investigations

"Investigation" is a word commonly associated with finding out who commits a crime or what causes an accident and hence, we consider that it may not be appropriate to use such word to describe the due diligence work of sponsors (and financial advisers) and IFAs on a prospective issuers or a listed issuers as such primary purpose is not to find any faults, if any, caused by the issuers or professional incompetence, if any, caused by other professionals. It is suggested to use words such as "due diligence review" instead of "investigation".

We agree that the sponsors should conduct due diligence to satisfy themselves that (i) the new applicant is suitable for listing, the new applicant's directors appreciate the nature of their responsibilities and the new applicant and its directors can be expected to honour their obligations under the Exchange Listing Rules and the Listing Agreement, and (ii) "non-expert sections" contained in the new applicant's listing application and listing documents are true and that they do not omit to state a material fact required to be stated or necessary to avoid the statements being misleading. **We disagree with the Exchange's proposed requirement for the sponsors to conduct due diligence to satisfy themselves that "there are no reasonable grounds to believe that the "expert sections" contained in the new applicant's listing application and listing documents are not true or omit to state a material fact required to be stated or necessary to avoid the statements being misleading".** While the "non-expert section" is normally prepared by the sponsor firms after their due diligence on the prospective listed issuer and study on the matters relating to the foregoing, we are relatively comfortable with the "non-expert section" requirement subject to the fact that sections headed "statutory and general information" and "summary of relevant laws and regulations" and confirmation and opinion appeared in the "business" section should be regarded as "expert sections". However, the "expert sections" are prepared by the relevant experts and some of which are the full extraction of the expert reports, staff of the sponsor firm may not have the requisite experience or expertise in such areas to make sure that the content is true or does not omit to state a material

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

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fact required to be stated or necessary to avoid the statement being misleading. In this regard, the Exchange is expected to liaise with the relevant self-regulating professional bodies to step-up their regulation and guidelines for listing work. Therefore, the relevant revisions in the Exchange Listing Rules and the Code of Conduct should be effective simultaneously with these regulations on other professionals.

With respect to the work of IFAs, one should note that the IFA can provide either "for" or "against" opinion in respect of a particular transaction after having conducted its study and analysis. Therefore, it is suggested paragraph 147 of the Consultation Paper to revise as "to take all reasonable steps to satisfy themselves whether the terms and conditions of the transaction…"

In practice, IFAs will mostly be appointed after the publication of the transactions and according to the Exchange Listing Rules, the listed issuers are required to despatch the circulars relating to the concerned transactions within 21 days after the announcements having been published. We consider that 21 days' time (excluding the bulk-printing time for circular, it would be 18 or 19 days) is not sufficient for an IFA to carry out study and analysis to an extent that it can satisfy itself that "there are no grounds to believe that any information, expert advice or opinion relied on in relation to the transaction or arrangement are not true or omit a material fact".

In addition, we anticipate that there may be discrepancy of opinions between the IFAs and the listed issuers or/and the experts in respect of the transactions. Therefore, apart from the IFAs, the Exchange may consider to require the listed issuers to appoint financial advisers in respect of transactions of material and sensitive nature, for instance, connected transactions so that the financial advisers could advise the listed issuers on Exchange Listing Rules requirements, their legal obligations and structure of the transactions and carry out due diligence work on the "information relating to the transactions as to whether they are true or omit a material fact" and "review the expert advice or opinion relating to the transactions and conduct inquiries with the expert with a view to primarily ensure the understanding on the aforesaid information and the consistency of the disclosure in the expert report and the aforesaid information" well before the concerned announcement be submitted to the Exchange. We can see a number of advantages over this proposed arrangement for transactions of material and sensitive nature: (i) every aspects of the transactions will be in good shape before and at the time of the announcement being submitted to the regulators; (ii) the financial advisers will be the principal communication channel between the Exchange and the listed issuers; and (iii) the financial advisers would have sufficient time to carry out their due diligence work to satisfy themselves the abovementioned proposed requirement as they should be appointed by the listed issuers well before the announcement stage. However, the Exchange should note that this will increase the cost of listed issuers in carrying out the transactions and it is suggested to consult the listed issuers in this regard before implementation.

It is also stated in the paragraph 147 of the Consultation Paper that "to make a declaration in their report of the due diligence they have performed in order to reach a conclusion whether the terms of the relevant transaction…". Given the time constraints faced by the IFAs as discussed above, it is suggested "to make a statement in their letters of advice they have taken reasonable steps to satisfy themselves whether the terms and conditions of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole" instead.

香港中環皇后大道中九十九號中環中心十二樓
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Q12. Code of conduct for sponsors and independent financial advisers

We disagree that the Code of Conduct forms part of the Exchange Listing Rules and a breach of the requirements of the Code of Conduct constitutes a breach of the Exchange Listing Rules. We only agree with the Exchange in respect of the implementation of the proposed Code of Conduct as a code of best practice in order to provide guidelines for sponsor firms, IFA firms and their eligible supervisors and staff to understand their respective responsibilities and expected scope of work. However, some of the review procedures are commercially impracticable. Some of the review procedures require sponsors and independent financial advisers to have expert knowledge, instead of reasonable judgment, in whatever industries their clients are engaged. Otherwise, sponsors and independent financial advisers may need to engage other experts' work in order to check against the reliability of the work of the experts engaged by the clients. This is unnecessary when professionals such as the lawyers and accountants already have their regulatory bodies to scrutinise the standards of their work. It is also unfair to require sponsors and independent financial advisers to monitor the standards of work of these professionals. Our comments on the Code of Conduct are set out as follows:-

Clause no.	**Our comments**
---	As stated in our reply to Q11, "investigation" may not be an appropriate word to describe the due diligence work of sponsor (and financial advisers) and IFAs on a prospective listed issuers or listed issuers as such primary purpose is not to find any faults caused by the issuers or professional incompetence caused by other professionals. It is suggested to use words such as "due diligence review" instead throughout the Code of Conduct.
21(d)	In addition, as far as we are aware, the auditors will advise the listed issuers in respect of accounting and management information systems upon completion of their audit work and they are professionally equipped. One should note that auditors normally take at least a few months to finish off the field work and provide their advice to the client (including the accounting and management information system) at the end. This proposed requirement implies that the Exchange expects the sponsors to perform the same work as that of the auditors' and we consider this would be impracticable, repetitive and unnecessary.
22(c)	It is proposed in the Code of Conduct that due diligence should include inquiries with regulatory bodies. In anticipation of difficulties in receiving responses from regulatory bodies by sending inquiries to them by the Sponsor/IFA itself, we suggest that it would be helpful if the Exchange could endorse it as part of the due diligence in the inquiry letter sent out by the Sponsor/IFA.
22(d)	It is suggested to confine to Hong Kong only as it is impracticable to search for those all over the world.
22(e)	It is suggested to provide a time limit for such search, say the past seven (7) years. In addition, it is suggested that only those media articles are available to the sponsors.
22(g)	It is suggested to set criteria for sponsors to assess "conduct", for instance, criminal record, bankruptcy, etc.

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
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24(b) As the track record requirement for GEM issuers is two years, it is suggested to review the material financial statements of the GEM issuers over the past two years only. Based on our experience, external auditors may not be willing to provide comfort to sponsors. Therefore, it is suggested that the Exchange should liaise with HKSA and obtain its consent in this regard.

24(c) It is anticipated that problems would arise when trying to review, assess or interview the issuer's major suppliers and customers. In practice, we would request the issuers to arrange meetings with their suppliers and customers. As these suppliers and customers have no obligation to provide the information as requested or meet with the sponsors and there may not be publicly information available about these suppliers and customers, it is suggested that this scope of due diligence would only be on a "best effort basis".

24(d) Referring to our comments to 24(c), it may not be feasible to interview the issuers' third party customers, suppliers, creditors and bankers. Hence, it is suggested that this scope of due diligence would only be on a "best effort basis"

24(h) As it is required to disclose the material contracts of the issuers within two years in their prospectuses, it is suggested to review the material contracts <u>for the past two years</u> prior to the publication of their prospectuses.

24(l) Based on our experience, products and technology of some issuers (in particular GEM issuers) are unprecedented and unique, and therefore, objective data in respect of such industry may not be available. It is suggested to perform such due diligence in respect of the industry and target markets on a "best effort basis".

24(n) Sponsors may not have the expertise to carry out the technical feasibility investigation. This will be almost impossible for companies proposed to be listed on GEM where products and technology are usually unprecedented and unique.

24(o) Referring to our comments on 24(l) and (n) above, as the sponsors may not have the expertise in the products and technology of the issuers, it is impracticable for the sponsor to examine the stage of the applicant's development and the commercial viability of its products and technology.

25(b) As all the experts are engaged by the issuers and sponsor firms do not have any client relationship with these experts, it is suggested that the Exchange should set out scope of work for each expert in the Exchange Listing Rules.

25(e) It seems to be impracticable and unreasonable for the sponsors to confirm that the expert or professional does not have any direct, indirect or contingent interest in any of the securities or assets of the issuer, its connected persons, or any associate or affiliated company of the issuer. It is the responsibility of the directors of listed issuers and the relevant professional party itself to ensure these professional bodies to be independent. It is strongly suggested that the Exchange Listing Rules should build in such requirement and objective criteria so that the expert's or professional's independence or objectivity would not be impaired and each professional should provide to the Exchange the confirmation in this regard to assess its suitability. The Exchange may also consider maintaining a list of acceptable parties for each category of professionals other than sponsor firms (see our reply to Q.13).

香港中環皇后大道中九十九號中環中心十二樓
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28	It is suggested to align with the requirement under Rule 20.27 of the GEM Listing Rules that "either on normal commercial terms or, if there are not sufficient comparable transactions to judge whatever they are on normal commercial terms, on terms no less favorable to the listed issuers than terms available to or from (as appropriate) independent third parties".
30(b)	Referring to our reply to Q.11, it is not reasonable for any independent third party not engaged in that business to have a thorough understanding and precise prediction of the future trends of that industry or business within a time span of 21 days and sometimes, based on our experience, the relevant industry statistics may not be publicly available. We suggest that this should be amended as "researching the relevant market and economic conditions and trends (if available) relevant to the pricing of the transaction".
30(d)	Please refer to our comments to clauses 25(b) and 25(e) above.
33	Please refer to our reply to Q10.

Q13. Declaration by sponsors and lead underwriters in listing documents to be registered

Although we most of the time act as both sponsor and the lead underwriter for IPOs, we undertand that in practice some of the lead underwriters would only be appointed at a later stage of IPOs, for instance after the submission of listing application forms or one or two weeks before the listing committee hearing. There may not be sufficient time for the lead underwriters to perform due diligence comparable with that of the sponsors (and financial advisers).

At present, we are not aware that the provision of due diligence confirmation to the Exchange on a private basis is a requirement. Nevertheless, we think that it would not be unreasonable for us to perform a high standard of due diligence but this can be regulated by the proposed Code of Conduct (see reply to Q.12), proposed amendments to the Exchange Listing Rules and a proper and effective reprimands or disciplinary sanctions (see reply to Q.16). Once the sponsor firms, the IFA firms, its eligible supervisors or its staff are proved to be in breach of the Code of Conduct or the Exchange Listing Rules, the relevant individuals or firms should be under reprimands or disciplinary sanctions. We believe that if a proper and effective reprimands or disciplinary sanctions system administered by the Exchange is in place, such as suspension of the qualification of a sponsor or independent financial adviser or eligible supervisors, it would be sufficient to encourage a sponsor or independent financial adviser or eligible supervisors to exercise due care in carrying out their work relating to IPO or significant transaction. **Hence, we do not see the benefits of providing such confirmations to either the Exchange or the public through making statements in listing documents.**

In addition, we note that there is expectation from the Exchange on the sponsor firms to perform alternative tests of due diligence in respect of "expert sections" in the listing documents. We, as a sponsor, also consider that reviewing the expert reports and conducting inquiries with the experts and the prospective listed issuers are part of our due diligence work, primarily to ensure our understanding on the issuers and information disclosed in the "non-expert sections" is consistent with that in the "expert sections". During this process, sponsor firms have to conduct its own study and analysis for those information contained in the expert reports that the sponsor firms may have reasonable doubt its basis and accuracy. However, we are of the view that the "expert sections" remain the primary responsibilities of the relevant professionals. **We consider that it**

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may not be reasonable for the sponsor firms to conduct alternative tests of due diligence in respect of the whole expert reports. As we mentioned at the beginning of this letter, the success of a listing exercise relies on each member of all professional teams as well as the prospective issuer and its directors. With a view to improving the quality of work of a listing exercise, regulating only the sponsors (and financial advisers) is not practical and sufficient if there is insufficient regulation by the Exchange on other professional parties involved in a listing exercise. **In addition, making sponsors responsible for all works of other professional parties is not fair to the sponsors.** As such, the Exchange should also think about how to enhance the professional standards of other professional parties and implement an effective reprimands or disciplinary sanctions system. Although some of these professional parties are governed by self-regulating quasi-statutory bodies, the Exchange may consider seeking consensus with these bodies as to their members' professionalism or implementing a regime to alert the professionlism of these professional parties as well, say maintaining a list of acceptable professional parties other than sponsor firms in respect of all significant transactions.

Q14. IFA due diligence declaration

Referring to our reply to Q.11, we suggest that, given the time constraints faced by the IFAs, the Exchange may consider requiring the listed issuers to engage financial advisers so that sufficient time would be allowed for the financial advisers to perform due diligence and preparation work for the transactions to an extent that they can satisfy themselves that "there are no grounds to believe that any information, expert advice or opinion relied on in relation to the transaction or arrangement are not true or omit a material fact".

As stated in our reply to Q.11, we suggest that "to make a statement in their letters of advice they have taken reasonable steps to satisfy themselves whether the terms and conditions of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole" instead. Currently, the IFAs have already included in their letters of advice the study and analysis they have performed in order to reach a conclusion whether the terms of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole and we, therefore, consider that the signed declaration setting out the due diligence they have performed would be unduly onerous and unnecessary.

Q15. Reporting obligations and monitoring

We agree with the certification process and the targeted programme of monitoring, which would streamline the administration work for both the Exchange as well as the sponors and the IFAs.

Q16. Compliance and sanctions

We agree that proper reprimands or disciplinary sanctions on individuals would promote a higher standards of listing and corporate finance work by the sponsors (and financial advisers) and the IFAs as it is always the eligible supervisors and staff to perform due diligence and not the sponsor firms and IFA firms themselves.

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

Q17 & 18. Ability of existing GEM and Main Board sponsors and IFAs to meet eligibility criteria for acceptance lists

We would meet the proposed eligibility requirements for sponsor firms and IFA firms, including the requirements that sponsor firms have four eligible supervisors and HK$10 million capital and that the IFA firms have two eligible supervisors if those requirements were in effect (i) today; (ii) in six (6) months' time; (iii) in 18 months' time; and (iv) in 30 months' time.

Others

Finally, we would like to take this opportunity to express our view as to anonymous complaints received by the Exchange prior to the listing of the issuers. As far as we are aware, having received the anonymous complaints, the Listing Division would make inquiries with the sponsors and expect them to return the replies/confirmation or/and to assist the issuers to clarify the matter through publication of announcements prior to the listings. We believe that some of these complaints may be genuine but some might be completely unfounded and some complainants may have other motives in making the complaints. It is suggested that the Listing Division would ask the complainants to provide sufficient evidence to justify making inquiries with the sponsors and requesting the issuers to publish clarification announcements in order to prevent abuse by disgruntled parties/ competitors. It is also suggested that the Exchange should make it a practice to disclose the identity of the complainants to the issuers, if requested, in order for the issuers to consider taking legal actions against these complainants should it be considered necessary and appropriate.

Should you have any other enquiries, please do not hesitate to contact our Ms. Venus Choi at 2218 2853 or the undersigned at 2218 2868.

Best regards,
For and on behalf of
Dao Heng Securities Limited

Stella Fung
Executive Director and General Manager

香港中環皇后大道中九十九號中環中心十二樓
12th Floor, The Center, 99 Queen's Road Central, Hong Kong.
Tel: (852) 2218 2828 • Fax: (852) 2285 3150 • Telex: 73584 HLSEC HX

(C.F.) I.S.