31st July, 2003

The Securities and Futures Commission
Corporate Finance Division
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Hong Kong

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Listing Division
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Dear Sirs,

Re : Response to Consultation paper on The Regulation of Sponsors and Independent Finance Advisers issued in May 2003

We refer to the Consultation paper on The Regulation of Sponsors and Independent Finance Advisers issued by the Exchange and the SFC jointly in May 2003 (the "Consultation Paper"). This letter set out our comments on the various proposal contained in the Consultation Paper.

Unless otherwise defined, terms used herein shall have the same meanings as in the Consultation Paper.

Our response to the proposals in the Consultation Paper are set out in two parts in this letter. Part A sets out our general comments thereto and Part B sets out our specific comments to the proposals in the order of the summary of questions set out in Annex 3 to the Consultation Paper.

PART A – GENERAL COMMENTS

Instead of responding to the questions posed in Annex 3 to the Consultation Paper, we have chosen to respond to the proposal in the Consultation Paper by way of a letter because it is our view that the design of Annex 3 is inadequate to deal with the complex issues raised in the proposal. Annex 3 sets out a summary of questions posed in the Consultation Paper and request the respondent to give a positive or negative answer to each question set out therein. However, each question raised a number of issues, some of which are acceptable, while others are unacceptable. We are of the view that by simply giving either a positive or negative response to the questions hardly do justice to the complicated issues raised in the proposals which have far fetching implications on the conduct of corporate finance advisers in the Hong Kong market.

It is proposed in the Consultation Paper that a common regime, administered by the Exchange be established regarding the acceptability of corporate financial advisers

who wish to act as sponsors or IFA to prospective applicants or listed issuers on either the Main Board or GEM and to provide further guidance to clarify the responsibilities of sponsors and IFA.

In principle, we have no objection to the concept of maintaining a uniform single list of sponsors / IFA for both the Main Board and the GEM. However, it is our view that new measures, if any, should be by way of strengthening the current framework as provided in the listing rules (both Main Board and GEM), the Securities and Futures Ordinance (Chapter 517 of the Laws of Hong Kong) ("SFO") and the various code of conducts introduced by the SFC. We do not agree and do not believe that the introduction of new regulatory framework outside and in addition to the current framework would improve the quality and standard of the listed companies up to international standard. History showed that no regulation is fool proof. The stringent regulatory framework in the United States of America cannot prevent corporate scandals like Enron and Worldcom, which shocked the world wide corporate community.

We believe that the introduction of a more comprehensive regulatory framework by expanding and strengthening the existing framework would increase the accountability of market practitioners and provide a more healthy environment. We do no believe that this aim can be achieved by shifting all responsibility to the financial advisers as suggested in the proposal. Furthermore, we appreciate that overseas regulatory regime offers certain successful examples which is a good reference point. Nevertheless, in considering new regulations, due regard should be given to the fact that Hong Kong is a unique market which serves as a platform for corporation established and/or operated in the People's Republic China ("PRC"). The unique political, social and legal infrastructure of the PRC produced a number of issues which cannot be found any other jurisdictions worldwide. Such issues often proves to be difficult and cannot be resolved with traditional solutions. We believe that any new proposals have to be able to allow market practitioners to meet the challenges posed by the unique features of the Hong Kong market while at the same time increase the accountability of market practitioners. The attempts in the proposal to import rules and regulations from foreign regime without due regard to the characteristics of the Hong Kong market are doomed to fail from inception. This is because the proposals have not provided for practical issues in implementation. Rules which cannot be put into practice cannot be good rules.

We are very disappointed at the proposals which simply import rules and concepts without any regard to the context in which such rules and concepts are being put into. We are also disappointed to see that the both the Exchange and the SFC attempts to introduce new rules with conducting any survey of the market as to the practicality of the proposals when as the regulators of the market, both organizations have full access to market statistics.

In relation to the proposals, our views can be summarized as follows:

(a) In principal, we agree to have a common regime for both the Main Board and the GEM by maintaining a list of acceptable of sponsor firms and IFA firms.

(b) We agree that in considering the acceptability of corporate finance firms onto the list of acceptable sponsor firms / IFA firms focus should be placed on the experience of the personnel of the corporate finance adviser instead of the firm, so as not to create unnecessary entry barrier for new firms managed and operated by experienced corporate finance advisers.

(c) We do not agree with the concept of maintaining a list of "unacceptable individuals". Instead, we are of the view that a list of "acceptable individuals" should be maintained.

(d) We do not agree with the new proposal of "eligible supervisors". The reasons for our objection to this concept are further elaborate in our response to question five below. We are of the view that the existing two tiers system of principal supervisor and assistant supervisor should be maintained. Furthermore, the proposal does not provide for other non-eligible supervisors, to become eligible supervisors.

(e) We believe the criteria for becoming an eligible supervisor as suggested in the Consultation Paper raised a number of controversial issues which should not be hastily implemented and should be subject to further proper and thorough consultation and discussion with market practitioners to ascertain the practicability of such proposals.

(f) We do not agree with the proposal that each sponsor firm should have four eligible supervisors and each IFA firm should have two eligible supervisors. We believe that this proposal is not practical and without reference to the market conditions which are beyond control of the market practitioners.

(g) We do not agree with the proposal on minimum capital requirement for sponsor firms because corporate finance advisory work is not by its nature capital intensive. We do not see the correlation between the work quality and the amount of capital as suggested by the Exchange in the Consultation Paper.

(h) We do not agree with the proposal that sponsor firms and IFA firms should provide undertakings to the Exchange. We agree that the code of conduct of sponsors should be revised and elaborate to provide clearer guidelines. However, the proposed code of conduct as set out in Annex 2 to the Consultation Paper raised a number of impractical and controversial issues which believe should be subject to further consultation and discussion. It is our view that the code of conduct should merge with the existing Corporate Finance Adviser Code of Conduct of the SFC so that corporate financial advisers would only be subject to one set of uniform rules instead of two different set of rules. Furthermore, with the concept of "fit and proper" being administered by the SFC, it is more rational to revise the current Corporate Finance Adviser Code of Conduct instead of introducing a new code of conduct.

(i) We do not agree with the proposal of mandatory appointment of a sponsor firms as on-going sponsor for all listed issuer on the Main Board and the

GEM. This is because for a majority of the listed companies this is not necessary given that level of corporate activities of most of the listed companies. We believe that the UK system of requiring the appointment of sponsors in a wide spectrum of corporate finance activities is more beneficial to the market and provide better protection to minority shareholders

(j) We agree in principal that sponsor firm should ensure that they are not in a position of conflict of interests and should be able to discharge their duties impartially and adequately. However, we do not agree with all the instances set out in the Consultation Paper as instances in which a sponsor firm is regarded as not impartial. We believe that the role of a sponsor should be distinguished from that of the IFA in this regard.

(k) We do not agree with the proposal that lead underwriters should give the same undertaking as sponsors regarding the content of a listing document in view of the role of the lead underwriter in an IPO.

(l) We agree that the administration and monitoring of sponsors and IFAs on the relevant lists should be streamlined. However, we do not agree with the proposal that the Exchange should retain discretion beyond the certification by sponsors and IFAs.

It is our view that instead of introducing a new system to regulate the discharge of responsibilities of sponsors and IFAs, steps should be taken in the direction of some of the proposals set out in the Consultation Paper within the existing regulatory regime. We believe that the existing regime of having all corporate finance advisers regulated by the licensing system of the SFC under the SFO is working well and there is no need to introduce a two tier regulation system. Instead, we believe that the Exchange, as the front line regulator with close contacts with corporate finance advisers should strengthen its cooperation with the SFC so that the SFC can regulate and monitor the activities of the intermediaries subject to its regulatory regime more efficient so as increase the accountability of market practitioners.

We do not agree that the Exchange should retain an overall discretionary power in a number of aspects. This is because it is always difficult for discretionary power to be exercised in a consistent manner and discretionary power should be exercised on occasions to cater for unforesseable circumstances rather than as part of a set of rules. In addition, we have serious concern regarding the present standard of the personnel of the Exchange in administering the discretion. Discretions should be exercised by experienced market veterans, not inexperience persons who are out of touch or have no working knowledge of the market. If the Exchange considers appropriate to introduce a new complicated regulatory system with substantial residual discretionary power, we suggest that may be Exchange should first conduct an internal review of the credential of its personnel before taking the proposals any further. Regulation without proper enforcement would reduce the regulations to "paper tiger" and do not serve any meaningful purpose apart from adding to administrative burden of market practitioners and hinder the growth, development and competitiveness of the market.

PART B – SPECIFIC COMMENTS

Q1. **Acceptable sponsor firms**

Whilst basically the proposal of maintaining a list of acceptable sponsors is acceptable, it is our view that a single list should be maintained for both Main Board and GEM.

Furthermore, it is our view that the current proposal has left a number of critical and practical issues unprovided for, including but not limited to:

- whether a sponsor who is admitted to the list of sponsors for GEM will be automatically admitted to the list of sponsor for Main Board and vice versa; or do sponsors have to make separate application for admission to the list of sponsor for Main Board and GEM, respectively?

- if separate application has to be made for admission to the list of sponsors of GEM and Main Board separately, is it a procedural matter or will the application be independently vetted by the GEM Listing Division and Main Board Listing Division?

We are of the view that the above are very important issues which must be clarified for market practitioners to form an informed view on the proposals. In particular, the current experience with GEM demonstrates that the application process is a time consuming and tedious process with the same issues being queried by separate officers over a period of several months. In view of the proposed requirement that sponsors should complete at least one IPO each year to be continuing eligible, it would appear that the protracted administrative process of the Exchange on its own would render the proposal not practical, without taking into account the market conditions which will affect the chances of completing a corporate finance transactions and are beyond the control of the corporate finance advisers.

In addition, we have strong concerns on (i) the admission criteria(Questions 4 to 8), (ii) on-going eligibility(Question 5), (iii) independence(Question 10), and (iv) the transition process which no doubt assumes that there are sufficient personnel in the market for all existing corporate finance firms to meet the criteria and it is commercial sensible to maintain such number of staff irrespective of the market conditions.

Q2. **Acceptable IFA firms**

We believe that a list of acceptable IFAs can be maintained by the Stock Exchange. However, we also have strong concerns on (i) the admission criteria (Questions 4 to 8), (ii) on-going eligibility (Question 5), and (iii) the formation of the new list. Can those financial institutions which would like to be sponsors as well as IFAs make a single application for both qualifications? Although not all financial institutions are interested in the smaller IFA market, they may apply for such qualifications so that they have the flexibility of providing a wide range of activities for marketing purposes and to shelter from market downturn of any one aspect of corporate finance activities. As such, in addition to the applications launched by those financial institutions which have a focus on IFA market or are not currently qualified as sponsors, the number of number of applications could be significant and it

is important that suitable transitional arrangement be provided for to ensure that market practitioners can meet the requirements of the new rules within the stipulated timeframe. In this regard, we would like to query whether or not the Exchange has conducted a survey to access the volume of work it may be facing once the proposal is implemented and whether or not the Exchange has sufficient personnel to perform the duties on a timely and efficient manner?

Q3. **Acceptable individuals**

We do not agree with the proposal of maintaining a list of unacceptable individuals. We are of the view that a list of acceptable individuals should be maintained instead.

No reasons was set out in the Consultation Paper as to why the Exchange considers it is more appropriate to main a list of unacceptable individuals contrary to maintain a list of acceptable individuals. Nor are the criteria as to how the Exchange is to judge whether or not an individual should be put on the list of unacceptable individuals set out in the Consultation Paper. Given the far fetching implications on the livelihood of an individual whose name is being put on the last of unacceptable individual, which is make public on the website of the Stock Exchange, we consider the proposal to be highly objectionable. Not only will the livelihood of the individual affected, the image and reputation of the sponsor firm which employed the unacceptable individual will also be materially adversely affected notwithstanding that all/other eligible supervisors are capable to perform the duties of a sponsor.

Furthermore the Consultation Paper does not set out the mechanism for an unacceptable individual to apply to be struck off from the list or to appear against the decision of be ruled as an unacceptable individual. It is a fundamental legal concept that no rules should take away a person's livelihood unless that person is given adequate opportunity to state his/her case with due and proper right of hearing. We do not see the rationale for the Exchange to introduce such controversial rules without due regard to a basic administrative principle, which governs the decisions of the Exchange. We are concern that the introduction of such concept may bring about a lot of administrative review action against decision of the Exchange which would involve substantial expenses. As a listed company, we do not think it is proper for the Exchange to introduce such rules which would end up spending substantial financial resources of the listed company not to the benefit of its shareholders. As an advocate of protection of minority shareholders, we are indeed shocked by the proposal which is obviously made recklessly without any regard of the interests of the minority shareholders of the Exchange.

It is stated in paragraph 55 of the Consultation Paper that the purpose of the proposals contained in the Consultation Paper is "*necessary to preserve the reputation and integrity of Hong Kong equity market*". It is difficult, if not impossible to understand how the maintenance of a list of unacceptable individuals can help to preserve the reputation and integrity of Hong Kong equity market, while the maintenance of a list of acceptable individuals which is more acceptable to market practitioners and do not have the problems state above cannot achieve the same goal.

Under the SFO, all personnel engaging in the provision of corporate finance

advisory work have to be licensed/registered thereunder. In applying to be licensed/registered under the SFO, an individual has to demonstrate that he/she is "fit and proper". It is difficult to imagine how can an individual who pass the "fit and proper person" test of the SFC and yet be regarded as an unacceptable individual by the Stock Exchange. We think that this double standard will create rather embarrassing situations where a person is properly licensed under the SFO to carry out corporate finance work and yet regarded as an "unacceptable individual" by the Exchange.

Q4. Competence and experience of the sponsor and IFA firms

We agree that focus should be put on the experience of the individual member of staff, rather than the sponsor firm or IFA firm to avoid creating entry barrier to new firms staffed by experience personnel. However, we have strong concern about the requirement that the sponsor firm or IFA firm should have at least four eligible supervisors and IFA firms should have at least two eligible supervisors. The number of personnel employed by a firm depends on the level of activities and also the then market conditions.

In addition, under the current regime on Codes on Takeovers and Mergers, a fir with only one licensed person licensed to advise on takeover code matters can undertake work on Codes on Takeovers and Mergers. Matters on Codes on Takeovers and Mergers are as complicated as other corporate finance transactions and IPO, we do not see the rationale for the proposed requirements of two eligible supervisors to carry out IFA work.

We note that the UKLA requires the sponsor to have at least four eligible employees who (i) are being employed at an appropriate level of seniority within the sponsor, and (ii) have provided advice in connection with a significant transaction at least three times in the preceding 36 months and at least once in the preceding 12 months. It does not necessarily mean that the sponsor must have four "senior" supervisors. As such, we think that the GEM Board setting of having two Principal Supervisors and two Assistant Supervisors is good enough.

Q5. Qualification and experience criteria of eligible supervisors

Under the proposal, the eligible supervisors of a sponsor firm must have:

(a) a minimum 4 years of relevant corporate finance advisory experience; and

(b) substantive involvement in at least 3 significant transactions, which have been completed.

Our objections to the proposal are as follows:

(a) An eligible supervisor is required to have at least four years of relevant corporate finance advisory experience derived in respect of companies listed on recognized stock exchanges or from other channels, such as experience gained from employment with listed companies listed on the Stock Exchange. Although it is not very clear from the proposal, it appears that experience gained by auditors

and lawyers in advising listed companies on corporate finance matters will not be taken into account. It is our view that the platform for recognized corporate finance advisory experience is too narrowly set. Under the policy statement of the TSX, an officer is not required to have "at least five continuous years of relevant experience with an underwriter" if that person can satisfy any one of the other requirements, e.g., a licensed CFA or CBV. In the premises, we suggest that if a person can demonstrate that he/she has acquired the relevant experience from avenue other than listed companies or sponsor firms, such experience should also be recognized.

(b) One of the common problems of current GEM regime is the treatment of "career breaks". For example, a person may take a prolonged holiday between jobs. Under the proposal, that person will not be regarded as having a continuous track record. However, in fact, that person is no different from a person who take two months holiday every year when working on a job. We do not see the reason why a person's previous experience would not be counted simply because he decided that he would like to take a two months holiday between two jobs. We do not agree that a person's preference of life style should affect that person's eligibility.

(c) Compare with oversea jurisdictions, the proposed requirement of four years experience with at least one transactions completed within the previous two years are also too long and stringent. Under the UKLA, an individual is required to be involved in three transactions within a period of 36 months. There is no requirement that the transactions have to be completed. Whether transactions can be completed or not depends on a number of factors. It is not usual for complicated transactions to take over years to complete.

(d) Under the proposal, experience derived from recognized over markets will be recognized and only one significant transaction in Hong Kong market is required. While we agree that only recognizing "local experience" is too stringent, requiring local experience in only one significant transaction without imposing time limitation as to when such experience is gained will defeat the purpose of ensuring that eligible supervisors understand and have experience of the Hong Kong listing rules. In an ever changing market, particularly the unique feature of each individual market, recent local experience should be a fundamental criteria for assessing the knowledge and experience of an eligible supervisor in Hong Kong listing rules.

(e) The definition of "significant transactions" is too narrow. The proposed definition set out in paragraph 76 does not included top-up placing / placing, debt restructuring, rescue proposal, redomicile, capital reorganization, major and discloseable transaction, whitewasher application. No reasons have been given why some of the transactions are recognized as "significant transactions" but not others. In particular, it is accepted in UKLA that a related party transaction involving the preparation of a circular is qualified (and so does the GEM Board under current practice).

(f) In paragraph 75 of the Consultation Paper, a "substantive role" means "*a role as a member of the sponsor firm's core transaction team in delivering or managing the delivery of one or more of the major components of due diligence work*

undertaken in respect of an engagement". The definition contains a number of ambiguous concepts which are subject to the discretion of the Exchange and may prove to be difficult. Such concepts include the meaning of "core transaction team", "managing the delivery", "major components of due diligence work". Depending on the complicity of the engagement, different personnel may involve in different phases of the engagement. Moreover, the definition appears to cover due diligence work only, what about the transaction team that advice on the terms of the transactions and execute the same? It is our view that instead of the requiring the delivering or managing the delivery of the due diligence work of an engagement, the requirement should be "providing advice" as presently adopted in the UKLA and by the GEM Board.

Our primary concern of the proposal is if (i) a firm is IPO focused and (ii) the "substantive involvement" in an IPO cannot be claimed by more than one eligible supervisor as proposed in the Consultation Paper, this would mean that the firm must have at least 4 IPOs in a single year which are handled individually by each of its eligible supervisors for the four eligible supervisor to fulfill the ongoing requirements. However, whether the IPOs can be completed is also subject to the then market condition. Besides, if there are more than 50 sponsors in the market, the number of eligible supervisors will be at least 200. Given that each of them must complete at least one "significant transaction" in the recent year to fulfill the proposed ongoing requirement, the market would have to be able to substantiate the number of transactions. We doubt whether or not the Exchange has conducted a survey of the market conditions before making the recommendations and we cannot understand how the quality of the market be improved by unrealistic and impractical proposals. In recommending rules of other jurisdictions, we query whether the Exchange has reviewed the structure and working of such oversea jurisdiction. What works for other jurisdiction may not work in the Hong Kong market which has its own unique characteristics not share by any other oversea market.

Q6. Other factors relevant to the eligibility criteria

We consider that objective criteria and a clear explanation be provided by the Exchange for exercising its discretion to refuse or cancel a sponsor's acceptance. For example, of the four criteria listed out in paragraph 80 of the Consultation Paper, it is unclear as to the circumstances the Exchange will exercise its discretion regarding capability to satisfy paragraph 7 of the proposed Code of Conduct for Sponsors and Independent Financial Advisers and remedial steps regarding suspension or revocation of regulatory status. Again, as stated above, rules that allowed the enforcement regime to retain substantial residual discretion are not good rules and tend to be confusing rather than an effective means in improving the market.

Q7. Minimum capital requirement of sponsor firms

We do not agree with the proposal that sponsor firm should have a minimum capital requirement of HK$10 million. On the other hand, we concur that there should not be minimum capital requirements for IFA firms.

For a practically point of view, corporate finance advisory work is not capital intensive, although the Stock Exchange has stated in the Consultation Paper that it is

not convince by this argument. it is stated in paragraph 85 of the Consultation Paper that the "*principal purpose of establishing capital criteria is to ensure that the sponsor firm has adequate resources to fulfill its role as a sponsor and the responsibility it accept*". However, the Consultation Paper does not elaborate as to why such large amount of capital of required for corporate advisory work or the relationship between the capital amount and the work of the sponsor.

Q8. Undertakings to the Exchange

We do not agree with the proposal.

Under the proposal, both sponsor firm/IFA firms and individual eligible supervisors have to provide the Exchange with an undertaking. Under Section 23 of the SFO, the Exchange is to provide a fair, orderly and efficient market for the trading of securities. As such, we doubt whether "the sponsor (and also its eligible supervisors) to make the proposed undertakings to the Exchange of complying with (i) the relevant listing rules applicable to sponsors and (ii) the proposed Code of Conduct for Sponsors and Independent Financial Advisers" is essential to the Exchange for providing a fair, orderly and efficient market for the trading of securities.

Moreover, we are uncertain as to whether the listing rules which are designated for governing the listing of securities (and also their issuer) will be abused if the statement of "a breach of the undertaking will be deemed to be a breach of the Listing Rules ....." is so established. We do not see the reason for the listing rules which governed the listing of securities on the Exchange should be extended to govern corporate finance advisers when they are currently subject to the regime of the SFC.

Q9. Appointment

We do not agree with the proposal.

It is proposed to discontinue the concept of co-sponsorship, but to allow more than one sponsor for ""*large IPO" in which it is necessary for more than one sponsor*", in which case one of the sponsors will be designated as the "primary sponsor". It is not clear under this proposal as to the meaning of "large IPO". An IPO with a large offering size does not mean that is complicated as to warrant more manpower, so that the combine effort of sponsors are required. Furthermore, it is not spell out in the Consultation Paper as to who will determine whether more than one sponsor firm is required for an IPO. We are of the view that the issue as to whether or not more than one sponsor firm is required, it is much better for the issue to be determined by the market practitioner.

It is also proposed that both Main Board and GEM listed companies are to appoint a sponsor firm as financial adviser for a certain period of time. For reasons set out below, we strongly disagree with the proposal:

(a) The Exchange appears to be of the view that the appointment of on-going sponsor will improve the disclosure of listed companies. There is in fact no evidence that this is the case. This is because a sponsor firm can only provide the listed company with the requisite advice and guidance upon being provided with

adequate information or being approached by the listed company for advice.

(b) In spite of the potential substantial increase operating cost to listed companies, the Exchange appears to believe that this factor is irrelevant as the potential benefit to investors outweigh the cost factor. In this regard, we believe that before proceeding further with this proposal, the Exchange should conduct a survey to ascertain the frequency listed companies engaged in corporate finance activities. In fact, a majority of the listed companies do not engage in any corporate activities which has an implication under the listing rules, other than issuing interim reports and annual reports. For these listed companies, the benefit of appointing an on-going sponsor is marginal. In additional, the additional cost will affect the profitability of the listed companies. We are of the view that for a majority of the listed companies, the cost of appointing on-going sponsors outweigh the benefit, if any.

(c) In paragraph 108 of the Consultation Paper, the Exchange proposed certain circumstances under which the Exchange may grant a waiver from the requirement of appointing an on-going sponsor. Both suggested waiver application criteria requires the relevant directors or compliance officer to have certain experience and also an "unblemished compliance record". It is not clear what the Exchange would regard as "unblemished compliance record". If a director has been a director of a listed company which was in financial difficulty and could not pay for the auditors fee for the preparation of audited accounts for publication within the timeframe stipulated under the relevant listing rules. Given that failure to publish audited accounts on a timely basis is a "strict liability" breach of the listing rules. In such circumstances, the director cannot be said to have an unblemished compliance record although the breach is not the result of has failure to comply with the listing rules but cause by factors beyond his control. Alternatively, a listed company may be committed a breach of the listing rule while the relevant director is a director of that listed company. The breach was only detected after the director has left the employment of listed company A. A waiver was granted to listed company B. Will the waiver be revoked when it was brought to the attention of the Exchange that listed company A has committed a breach of the listing rules? How will cases where the Listing Division alleges a breach of the listing rules, but disciplinary proceedings has yet to be commenced be treated? It is not unusual for disciplinary proceedings to be brought two years after the occurrence of the alleged breach of the listing rules.

It is further proposed that in addition to the requirement of appointment of on-going sponsors, the Exchange has the discretion to direct a listed issuer to appoint a sponsor firm to provide it with advice for any period of time it specifies. Again, no detail criteria are set out in the Consultation Paper as to the circumstances under which the Exchange will exercise its discretion. In paragraph 113 of the Consultation Paper, in discussing whether or not the Exchange should use its discretion to direct listed companies that neither make extensive use of external advisors nor have adequate internal advisors to appoint a sponsor firm to provide it with advice, as opposite of a general requirement that all listed companies should appoint an on-going sponsor, the Exchange acknowledge that "*a difficulty in this approach would be establishing clear criteria which would allow consistent decision-making*". No reason was given in the Consultation Paper as to why the Exchange felt that this difficulty as

annunciated in paragraph 113 is not applicable to the proposal to retain the discretion in paragraph 110 of the Consultation Paper.

We are of the view that the appointment of on-going sponsors for the Main Board for listed companies should be subject to further consultation with listed issuers, applicants, potential applicants and investor public. It is not just a matter between the Exchange and the sponsors and the Exchange should not completely disregarded the cost factor.

The UKLA requires the appointment of a sponsor in the following situations:

> "*2.6 An issuer (other than a public sector issuer or an issuer issuing specialist securities or miscellaneous securities) must have appointed a sponsor when:*
> *(a) it prepares a shelf document or makes any application for listing which requires the production of listing particulars; or*
> *(b) (b) in relation to any transaction or matter a sponsor is required by the listing rules to report to the UKLA.*
> *2.7 In the event of a breach of the listing rules by an issuer, the UKLA may notify such issuer that the appointment of a sponsor is required to give advice on the application of the listing rules.*"

We believe that an approach similar to that in the UKLA should be adopted. We believe that the discretion to direct an issuer to appoint a sponsor firm to provide advice for any specified period can only be exercised by the Stock Exchange in the event of a breach of the Listing Rules (rather than in any situation as proposed in the Consultation Paper).

Q10. <u>Independence</u>

Although we agree that in some stances, set out therein do affect the independence of the sponsor firm /IFA firm, we do not think all the circumstances set out therein affect the ability of the sponsor to give "impartial advice" and to discharge its duties independently. Furthermore, we are of the view that a distinction should be drawn between sponsor for IPO and IFA in this regard.

According to the "Sponsor's confirmation of independence" as required by the UKLA, we note that the sponsor as well as its directors, partners and employees must report (i) whether they have any shareholding interest or directorship in the issuer and (ii) any other matters which may affect the independence from the issuer. As such, interests of any associates of the sponsor's directors and employees may or may not be a factor which can materially affect its independence. In particular, whether a business relationship (past or current) between the issuer and the sponsors' director or employee can also materially affect its independence may be subject to judgment. So, we do not consider that the existence of such interests or relationship should necessary prelude a firm from acting as a sponsor.

In addition, we note that the independence of an IFA relating to the Code-related matters is stricter than that relating to the Exchange matters. However, due to the nature of the Exchange matters, we think that a firm can qualify to be an IFA (other

than any shareholding interest) if it does not serve as a financial adviser to the issuer and its subsidiaries within the past 12 months.

Q11. Responsibilities

We do not agree that there is an expectation gap between the Exchange's view of the responsibilities of sponsors and the manner in which many sponsors are discharging those responsibilities simply because of the recent corporate scandals. No system is fool proof. Instead of finding out the reasons for the corporate scandals, the Exchange appears to take the view that such scandals are entirely the result of sponsors not being up to standard. No evidence was, however, put forward for this oversimplified conclusion.

It is currently set out in the Model Code for Sponsors of the Listing Rules (Main Board) that the purpose of the model code is to give guidance on the Exchange's minimum expectations of the sponsor's role. For instance, a sponsor should satisfy itself, on the basis of all available information, that an issuer is suitable for listing. Besides, a sponsor should be closely involved in the preparation of the listing document and in ensuring that all material statements therein have been verified. It is also specified in the model code that failure by a sponsor to meet such expectations without reasonable cause may render it unacceptable to perform the role of sponsor in future. In fact, this is what sponsors in Hong Kong have been doing all along.

It appears from the Consultation Paper that the rationale for the proposal as stated in paragraph 133 of the Consultation Paper is that "*recent experience in Hong Kong suggests that some sponsors to issues of securities on the Exchange are not performing their role to an adequate standard. In a number of cases in which problems have been identified with the accuracy of statements made in IPO prospectuses and listing application documents, sponsors have sought to disavow responsibility by saying that they relied on information provided by directors or officers at face value.*" It is further stated in that paragraph that the Exchange does not view such level of due diligence as adequate due diligence in the context of what is recognized as such in developed market. The Consultation Paper does not stipulated as to what evidence was being accepted on face value in respect of those IPO prospectuses where problems concerning accuracy of certain statements are identified. Nevertheless, no matter how in depth a due diligence review is, the starting point is always information provided by the potential listed issuer. Of course, certain information provided can be cross checked with information available in public records. However, there is no fool proof way to cross checked all data with public data. Furthermore, it is not unusual for companies not to keep everything in writing. Business are conducted mostly by verbal exchanges around the world. For example, transactions may be occurred between the listing applicant and a third party who is a natural person and the directors of the listing applicant claimed to have no relationship whatever with them. There is in practice no way for a sponsor to cross check this information apart from making enquiries with the directors and that third party and accepted was being told on face value. We believe that whether or not the level of due diligence is adequate is a matter to be determined in the context of the particular issue taking into account the practical constraints.

Under the proposal, the Exchange proposes that sponsors should conduct

reasonable investigations in several areas of concern, namely (i) suitability of listing, (ii) "non-expert sections", and (iii) "expert sections" which allow the Exchange to rely upon during its assessment of the applicant's listing application and listing document. By sponsoring an listing application, the sponsor has in fact implied that the listing applicant meet the basic listing requirements, as such we believe that it is not unreasonable that sponsors should be required to take certain review procedures regarding the suitability of listing of the issuers.

The proposal that a sponsor should take responsibility to ensure that certain sections of the prospectus are true and no material fact is omitted therefrom to make the same misleading is unreasonable. In respect of "non-expert sections", sponsors may have difficulty in assessing the correctness and completeness of certain information notwithstanding that they have exhausted all possible avenue to ascertain the truth and completeness of the information. In most instances, sponsors would expressly warn readers of the practical difficulty although it is the practice of the Exchange to request the deletion of such warning statements in total disregard of the practical difficulty facing sponsors and the consequence of not having such a warning statement. If, for instance, the company's management predicts that the industry growth is about 20 per cent. per annum for the coming five years. In relation to this estimation, a sponsor can (i) to obtain research reports, (ii) observe the pattern of past industry growth, (iii) study other relevant markets (e.g. upstream, downstream or overseas), and (iv) perform an industry analysis itself, so as to verify the accuracy of the statement and to present the statement in a context which will not create a misleading impact. But there is always a limitation as to what a sponsor can do and a sponsor cannot predict unforeseeable circumstances which may later prove the statement to be incorrect or there may be lack of official statistics in the industry, as a result of which the sponsor would have to rely on unofficial statistics. As such, notwithstanding that the sponsor has done what it reasonable can do in the circumstances, it can still never be able to fully satisfy itself and/or to assure the Exchange that all the information set out in the "non-expert sections" is without any omission or not misleading.

On the other hand, if the experts so appointed are independent from the issuer and qualified for providing the information set out in the "expert sections", we believe that it is sufficient for the Exchange to rely upon their statements. Considering the approach of the TSX on the use of experts (a copy of which is attached) which we believe are more reasonable and practical, the responsibility of a sponsor should be no more than assessing the independence and qualification of such experts. In fact, it is not possible to confirm whether or not the statements in the "expert sections" are true and there is no omission of material fact required to be stated or necessary to avoid the statements being misleading without going through the working papers of the experts. However, working papers of "experts" in most instances are confidential information governed by client confidentiality and cannot be disclosed to a third party by the expert. Moreover, most experts are reluctant to hand over their internal working paper to a third party for review which would render it inherently impossible to conduct the necessary review so as to give the required statement to the Exchange.

Lastly, we would like to point out that in Hong Kong, the Exchange adopts a very hands on approach in vetting information set out in prospectuses and circulars. This approach resulted in the vetting of underlying materials and information in

support of a particular statement and also the mandatory inclusion of certain statements. We query whether where the Exchange has practically review the due diligence work of the professional advisers and insisted that certain disclosure be made in a particular manner with certain wordings (because this is what is being stated in a "precedent case" in total disregard of the particular circumstances), sponsors and IFAs should bear such an onerous responsibilities.

Q12. Code of Conduct for Sponsors and Independent Financial Advisers

We agree with some of the matters set out the Code of Conduct for Sponsors and Independent Financial Adviser (the "Code of Conduct"). It is proposed in the Code of Conduct that it will be a requirement of the Corporate Finance Adviser Code of Conduct issued by the SFC that a registered person under the SFO has to observe the requirements of the Listing Rules including the Code of Conduct. Given that breach of the Code of Conduct would cast prima facie doubt on the fitness and properness of that person with respect to their registration under the SFO. As such, we do not see the reason for the Exchange to insist that a breach of the requirements of the Code of Conduct constitutes a breach of the Listing Rules. Such provisions would render a person subject to the regulation of both the Exchange and SFC which is not necessary. This is because a person who has breached the Code of Conduct may not be regarded as fit and proper and his registration under the SFO would probably not be renewed. We do not see the reason of having a single breach of regulation subject to proceedings of two regulatory authorities. In this regard, we are of the view that the Exchange should coordinate with the SFC to enable the SFC to take appropriate action under the SFO. We are of the view that the Code of Conduct should be a code of practice to help the firms improve their corporate governance and operations (Question 6).

We consider that the proposed requirements set out in the Code of Conduct should be strictly applicable only to sponsor firm(s) and IFA firm(s) (but not their eligible supervisors, other directors and/or staff) given that it is the firm rather than the individual to accept and perform the work for an issuer. In addition, we have concerns whether it is practicable for (i) a sponsor or (ii) an IFA to fully satisfy itself and/or to assure the Stock Exchange whether (i) all the information set out in the "non-expert sections" in relation to an IPO, or (ii) all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement respectively, is without any omission or not misleading.

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

We do not agree with the proposal and it is our view that the proposal is made without giving any regard to the market practice in Hong Kong and the role of a lead underwriter in a Hong Kong IPO. No reason is given for the proposal nor has the proposal deal with the different role of a sponsor and a lead underwriter. Whatever due diligence the lead underwriter has undertaken, such due diligence work are undertaken for the purpose of deciding whether or not to underwrite the offer, not for the purpose of making public statements to the investing public. On the other hand, a sponsor in sponsoring the listing application has given various confirmation to the Exchange and under current practice, also regarded as an "expert" under the

Companies Ordinance.

First, we have considered the approach taken by the UKLA, the TSX and the ASX in this regard. We noticed that there is no such kind of declaration required to be made by the sponsors and the lead underwriters in the listing documents to be registered. In particular, for the related "expert sections" found in the ASX {see attachment VII}, if the prospectus includes a statement purporting to be made by an expert, the prospectus can be issued once the expert has provided its written consent (and being stated therein). It seems to us that the expert itself is responsible for its statement or opinion expressed in the prospectus.

As mentioned in Q11, we note that the Exchange proposes to request the sponsors for conducting reasonable investigations on several areas of concern, namely (i) suitability of listing, (ii) "non-expert sections", and (iii) "expert sections" which allow the Exchange to rely upon during its assessment of the applicant's listing application and listing document. While, according to the proposed requirement herein, the Stock Exchange would like the sponsor to make a declaration regarding its reasonable investigations on "non-expert sections" and "expert sections" in the prospectus subsequent to its vetting process. We wonder whether it is necessary to do so. Nevertheless, as discussed earlier, notwithstanding that we, as a sponsor, can make investigations (or any applicable review procedures), it is impracticable for us to fully satisfy itself and/or to assure the Exchange whether all the information set out in the "non-expert sections" is without any omission or not misleading. Given the aforesaid limitation, we consider that the sponsor (or the lead underwriter) is not able to provide such declaration. It may be more appropriate to advise the investors to be fully aware of the particular nature of the information set out in the "non-expert sections".

Q14. <u>IFA due diligence declaration</u>

We do not agree with the proposal.

It is proposed that the Exchange would also like the IFA to perform due diligence work in assessing the correctness and completeness of all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement and to make a declaration thereon in its letter as enclosed in the circular subsequent to its vetting process. Again, notwithstanding that an IFA, can make appropriate steps and due diligence work, as in the case of sponsors, it is impracticable for the IFA to assure the Exchange that all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement is without any omission or not misleading. Given the aforesaid limitation, we consider that the IFA is not able to provide such declaration.

Q15. Reporting obligations and monitoring

We agree that it is appropriate to streamline the administration of the sponsor and IFA regime. However, using a certification process and a targeted program of monitoring cannot be served as a "complete" system for assessing the suitability of a firm as a sponsor or an IFA. As such, we suggest that the Exchange should work closely with the SFC in this regard, given that all corporate finance advisers are subject to the direct regulation of the SFC.

We do not agree that the Exchange should retain an overall monitoring power. The Consultation Paper is not clear as to the circumstances under which such power will be used and it is highly likely that the power will be abuse to such an extent that the residual monitoring tools would become the main crust of the monitoring rules without according the same the status of formal rules. This is highly undesirable as this would not only add to administrative burden but also create confusion for corporate finance advisers. Furthermore, we are of the view that a number of monitoring tools suggested are not of sufficient objective for an objective unbais assessment. Moreover, it is not clear from the Consultation Paper as to the credential of the personnel of the Exchange who are to administer such monitoring tools. .

Q16. Compliance and sanctions

We are disappointed to learn that the rationale for imposing penalties on sponsors or financial advisers or any of their members of staff is to promote high standards of conduct and ensure that regulatory standards are being upheld. We wonder why the Exchange is of the view that supervisors having the qualifications and experience are still perceived to be unable to help discharge the sponsors' responsibility.

We are of the view that existing listing rules have already provided sufficient and proper measures on any breach of duty by the sponsors relating to matters governed by the listing rules. We do not think that it is appropriate to extend such measures to individuals since it is the firm (but not the individual herself/himself) that undertakes the engagement to perform the sponsor's work for an issuer. We are of the view that the introduction of the list of sponsor firms / IFA firms and list of acceptable individuals should be sufficient for the Exchange to assess and monitor the work and professional conduct of an individual. Furthermore, all such individuals are subject to the regulatory regime of the SFC which we believe is adequate and sufficient for the purpose. By working closely with the SFC, the Exchange should be able to achieve the same result without having to introduce a second tier regulation.

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

(a) Yes, if effective today.
(b) Yes, if effective in 6 months time.
(c) Not certain, if effective in 18 months time.
(d) Not certain, if effective in 30 months time.

We refer to our concern set out in Question 5 that it is uncertain as to whether each of our 4 "eligible" supervisors can complete at least one "significant transaction"

in the then recent year to fulfill the proposed requirement. Nevertheless, we would like to reiterate our response to Question 4 that the requirement as stipulated by the UKLA does not necessarily mean that the sponsor must have four "senior" supervisors. In fact, we think that the GEM Board setting of having two Principal Supervisors and two Assistant Supervisors is sufficient and so far, prove to serve the purpose and is working well.

Yours faithfully
For and on behalf of Kingston Corporate Finance Limited

Alvin H. Y. Leung
Head of Mergers and Acquisitions &
Corporate Advisory