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Barits Securities (Hong Kong) Limited

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31 July 2003

THE STOCK EXCHANGE OF HONG KONG LIMITED

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

By fax no.: 2295 3599
& by hand

073530

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

By fax no.: 2810 5385
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Dear Sir/Madam,

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

We refer to the Consultation Paper provided in May 2003. We would like to give you our views on the issues set out below on which we would like to express our particular concerns. Unless otherwise defined, terms used herein shall have the same meanings as in the Consultation Paper.

Undertakings to the Exchange

As far as we are aware, such undertakings are not currently required in other established jurisdictions. We note that the current GEM Listing Rules require prospective sponsor firm to meet certain eligibility criteria and undertake to comply with the GEM Listing Rules applicable to sponsors. Pursuant to such undertaking, the Exchange may impose a sanction against the sponsor or any of its employees if there has been a breach or failure to discharge the responsibilities under the GEM Listing Rules. Besides, it is a market practice that one of the major responsibilities of sponsor firms and IFAs is to assist the Exchange with investigations, among other things, by producing documents and answering questions fully and truthfully.

On the above basis, we could not understand why it is necessary for prospective sponsor firms and IFAs and their employees to sign further undertakings to comply with the same. We suggest that the Exchange may consider extending current

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requirements under GEM Board to the Main Board if they expect Main Board sponsors be governed by the same requirement standards.

In addition, given that there is no well developed professional insurance system in Hong Kong to protect employees from losses or damages arising from his/her employment, we consider that it is far from mature to request personal undertakings from employees of sponsors.

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

As far as we are aware, there is no such kind of declaration required to be made by the sponsors or the lead underwriters in listing documents in all of the UKLA, the TSX and the ASX. In particular, in respect of the ASX, when a prospectus includes a statement purporting to be made by an expert, a written consent from such expert is sufficient for the issue of prospectus. Accordingly, such requirement implies that the expert itself is solely responsible for its statement or opinion stated in the prospectus.

In respect of the "expert sections", we believe it is a fundamental mistake to require a non-expert, that is, a sponsor or lead underwriter, to take responsibilities for the expert. Each professional advisers who are involved in the process of bringing potential issuers to the market shall share the responsibilities to enhance their respective standard of works. The proposal to require a sponsor to give a negative confirmation that the "expert sections" are true and free from omission of a material fact implies that it is the duty of a sponsor to exercise professional judgment on the advice or works provided by other professional advisers, for example, the "true and fair" view given by accountants or the likelihood of successful claims against the potential issuer provided by a legal councel. We are simply not qualified to perform such professional roles.

Practically, we have experienced difficulties in obtaining the full support of other professional advisers when their professionalism is repeatedly challenged. Hence, it is our view that if the experts so appointed are independent from the issuer and qualified to provide the information set out in the "expert sections", it shall be sufficient and reasonable to place reliance on their statements and it is the responsibility of the Exchange to find a way to take disciplinary action against such

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expert in case of frauds being proved in relation to their works.

It is stated in the Consultation Paper that the sponsors are closely involved in the preparation of the listing document and provide the Exchange with explicit confirmations regarding the listing document, there is an argument that liability for prospectus misstatements already extends to sponsors and underwriters as promoters of the company. However, we are of the view that it is not practicable and not appropriate for sponsors or lead underwriters to bear liability for every statement in the prospectus.

For instance, when the issuer is a bio-pharmaceutical company in the PRC and its PRC legal advisers have made a statement in the prospectus that such issuer has obtained all relevant licences and approvals in regard to its establishment and operation in the PRC, does a normal person expect a sponsor or lead underwriter possess the necessary professional knowledge to opine on or concur with that view or to assess whether all PRC legal opinions in the prospectus are correctly stated?

We are of the view that as far as the experts which give opinions or make statements in the prospectus are qualified independent third parties, they should be solely liable for their opinions made and the extent of due diligence of sponsor in such regard should be limited to assessing whether such experts carry the necessary qualification and expertise and are independent third parties under definition of the Listing Rules or the GEM Listing Rules.

As a sponsor to an issuer, it is our duty to conduct investigations and due diligence work to our satisfaction on various aspects of a prospective issuer, in particular, its suitability for listing. We would in our best endeavors obtain separate documents from independent sources so as to examine the reasonableness of, among others, the financial performance, business model and future prospects of a prospective issuer. In line with market practice, we would also engage a Hong Kong legal advisers to conduct vetting and verification of listing documents with an aim to support each and every statement therein by proper documents. In the process, however, it is inevitable that certain statements in the listing documents could only be supported by representations or confirmations provided by management of the issuer.

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For instance an initial management shareholder of an issuer is a venture capital fund and apart from the issuer, has made numerous investments in the course of its business. It has confirmed to the issuer that none of its investees is engaged in a competing business as the issuer. In light that such venture capital fund is a private company and given the confidential nature of its investment portfolio, it is impossible for a sponsor to tap an independent source to verify the correctness of such confirmation notwithstanding the risk that one or more of its investments may compete with business of the issuer.

In conclusion, in relation to the non-expert sections, we are of the opinion that it is not practicable, if not impossible, for a sponsor to fully satisfy itself and assure the Exchange that all information set out in the non-expert sections is not materially misleading or false since as demonstrated above, a sponsor may have difficulty in assessing the correctness and completeness of certain information in listing documents, notwithstanding what kind or depth of due diligence work such sponsor has conducted. In view of such limitation, we believe the best sponsors could do is to highlight investors to be fully aware of the nature and potential risk of the information set out in the non-expert sections.

Competitiveness of the Exchange

In order to make the proposed declaration by sponsors and lead underwriters in listing documents and discharge their due diligence responsibilities to their satisfaction, regarding certain statements in listing documents made by other professionals (as the example mentioned above), sponsors and lead underwriters may be obliged to retain their own team of professionals: PRC legal advisers, HK legal advisers, accountants and valuers, to conduct independent due diligence and provide their opinions to sponsors and lead underwriters to back up their declaration made in listing documents.

Under current market practice, a HK legal advisers is usually the only professional party engaged by sponsors for IPO exercises which is principally responsible for verification of content of listing documents and drafting of underwriting agreement. Accordingly, in order to fulfill the declaration requirement, the cost on the part of sponsors for an IPO exercise would be substantially enhanced as compared to the existing market practice.

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It makes commercial sense that before being engaged, sponsors and lead underwriters would negotiate with prospective issuers that prospective issuers should bear such additional costs since such costs arise solely as a result of the IPO exercise. Accordingly, the listing cost for an issuer would significantly surge as a result of the new due diligence requirements on the sponsors.

Based on our experience, the amount of listing cost is always one of the top priorities of potential clients in considering which jurisdiction to get their company listed. Comparing to listing on the Shanghai Stock Exchange and the Singapore Stock Exchange, being the two major competitors of the Exchange for new listings, the total listing cost in Hong Kong is always criticized of too high, even before implementation of the enhanced due diligence requirements on sponsors. Accordingly, we are worried that the new declaration requirements would severely affect the competitiveness of the Exchange and may force potential clients to consider switching to other lower cost jurisdictions for listing.

It is stated in the Consultation Paper that for prospective issuers raising funds through global offerings, the Exchange do not believe that their requirements will give rise to any significant additional costs. While we have no comment on the above view, we believe that this is not the case for small to medium size companies. We note that there were about 110 completed IPO exercises in 2002 and only about 25% of them have a fund raising size of over HK$100 million. As such, the additional cost due to the more stringent due diligence requirements is anticipated to comprise a high proportion of the fund raising amount of most IPO exercises and the incentives of high growth small to medium size companies going public in Hong Kong would be most hard hit by the new due diligence requirements.

<u>Governance of other professional advisers involved in IPO exercises</u>

It is stated that the purpose of the Consultation Paper is to seek the view of market participants on proposals to reinforce the regulatory regime for sponsors, underwriters and IFAs due to the "expectation gap" concerning the responsibilities of sponsors existed between investors, regulators and some sponsors as well as the concerns raised that some sponsors are not properly discharging the responsibilities, which are normally associated with this important role in developed financial markets. However, we could not agree to the basis of the expectation gap because as mentioned, it is not

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practicable, if not impossible, for sponsors to fully satisfy themselves and assure the Exchange that all information set out in the listing documents is not materially misleading or false which is so assumed in the declaration proposed by the Exchange.

Legal advisers and accountants in Hong Kong operate within their own established regulatory framework, governed by self-regulating quasi-statutory bodies. We appreciate that in light of current arrangements between the Exchange and these professionals and the initiatives in hand, the Exchange is not proposing any new requirements in the Consultation Paper on professionals other than the sponsors. In such regard, we wish to highlight that many of those listed issuers which encountered problems in recent years are related to problem accounts, fraud accounts or legal related issues.

Accordingly, we cannot understand the basis why the Exchange consider auditors or reporting accountants could be sufficiently governed by their self-regulated bodies while as far as we are aware, the current arrangements between the Exchange and these professionals have been in place for years. Does it constitute an evidence that current arrangements are not sufficiently effective in avoiding problem accounts and hence protecting investors of such companies from relying on false accounts?

By the same token, legal advisers (advising on HK Law, PRC Law, Cayman Islands Law or laws of other jurisdictions) play an important role in each listing exercise given that their opinions are often critical in assisting the sponsors and the Exchange to assess whether a listing applicant is suitable for listing. However, the recent legal related issues of problem companies, principally those based in mainland China, may suggest that more stringent measures are necessary to properly govern the discharge of duties and due diligence work of legal advisers.

Backing on the above arguments, we wish to illustrate that given the ultimate objective of reinforcing the regulatory regime and improving corporate governance of Hong Kong listed companies, the governance on other professional advisers shall be considered as a whole and the Exchange should consider including in the Consultation Paper the relevant provisions to cover each ofother professional advisers. We believe only a comprehensive Consultation Paper which sets out the provisions to govern all professional advisers be effective in stemming out the possibility of corporate failures in relation to Hong Kong listed companies.

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Need for 2nd phase consultation

It is anticipated by the Exchange that the results and conclusions on the Consultation Paper will be published on or around end of October 2003, with a view to the new rules being published by 1 January 2004. In light of the particular importance of the Consultation Paper on the future regulatory regime for financial intermediaries and hence the future development of the IPO and financial advisory market of Hong Kong, we are of the view that a second phase consultation on the Consultation Paper, that is, a revised Consultation Paper, after having incorporated views and opinions of market participants (including the Exchange) during the first phase consultation, must be issued for another and final phase of consultation.

Based on our discussions with other practitioners, we see a substantial gap exists between the regulators and sponsors on the proposals to reinforce the regulatory regime for sponsors and underwriters, and we consider that substantial amendments shall be made to the Consultation Paper before its conclusion. The current status of consultation is simply too preliminary for a conclusion to be reached and a second phase consultation would allow the Exchange to explain and address the preliminary concerns of market participants while giving financial intermediaries an additional opportunity and allowing them more time to consider the views and opinions of other parties and to express their further or revised opinions.

More importantly, the Exchange and financial intermediaries could have more time to have a more thorough communication and reach a general consensus on the concluded opinions of the Consultation Paper. We strongly advocate that only with a second phase consultation could financial intermediaries give their grave support to the conclusions on the Consultation paper and only with their genuine support could the revisions proposed in the Consultation Paper be implemented smoothly and effectively after their adoption.

With the same interests of the Exchange to promote the Hong Kong stock market to be the first choice of many high growth and good quality companies from the Greater China Region and to enhance the role of Hong Kong as an international finance centre, we fully agree and support the Exchange to improve corporate governance and quality of listed companies. However, we consider that the Exchange should address market

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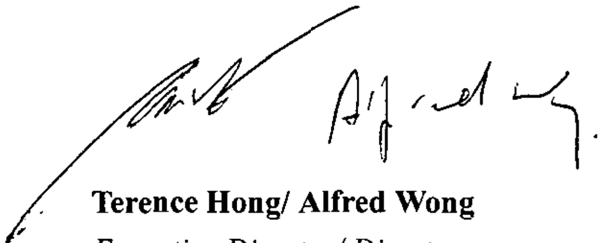
concerns in a proper and professional manner such that the reinforced regulatory regime could be carried out in an efficient way with market support.

Yours faithfully,
For and on behalf of
Barits Securities (Hong Kong) Limited



Terence Hong/ Alfred Wong
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