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TAI FOOK CAPITAL LIMITED
(Member of Tai Fook Securities Group)
大福融資有限公司

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

THE SECURITIES AND
FUTURES COMMISSION
ESTABLISHED

073239

Dear Sirs,

Re: Consultation paper on the regulation of sponsors and independent financial advisers (the "Consultation Paper")

Please see attached our comments on the Consultation Paper for your consideration.

We appreciate very much that market practitioners are given an opportunity to contribute to the revision of the Listing Rules and we hope our comments would be useful for your purpose.

Should you have any queries, please contact either our Steven Lo at 2213-8612, Kenneth Chow at 2848-4373 or the undersigned at 2801-2436.

Yours faithfully
For and on behalf of
Tai Fook Capital Limited

Derek Chan
Deputy Managing Director

ANNEX 3

SUMMARY OF QUESTIONS

ACCEPTABLE SPONSOR FIRMS

(Paragraphs 50 to 52 of Part B of the Consultation Paper)

We propose that to be eligible to act as a sponsor to a new applicant or a listed issuer, the firm is required to be accepted by the Exchange for such purposes and admitted to a list of acceptable sponsors maintained by the Exchange. 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. We propose that all first instance decisions in relation to eligibility on application; on-going eligibility and independence of a sponsor should be made by the Listing Division and subject to review, if necessary, by the Listing Committee.

Q.1 Do you agree with our proposal?

Yes

No

Please state reason(s) for your view

GEM has implemented such a system and we consider the establishment of such an acceptable list of sponsors could standardize the qualification criteria for being an eligible sponsor.

ACCEPTABLE IFA FIRMS

(Paragraphs 52 to 53 of Part B of the Consultation Paper)

We propose that only firms on the list of acceptable sponsors or acceptable IFAs be eligible to act IFAs to issuers in relation to a connected party transaction. We propose that a process similar to that for admitting firms to the list of acceptable sponsors be adopted for IFA firms.

Q.2 Do you agree with our proposal?

Yes

No

Please state reason(s) for your view.

We consider the establishment of such a system could standardize the qualification criteria for being an eligible IFA.

ACCEPTABLE INDIVIDUALS

(Paragraphs 54 to 59 of Part B of the Consultation Paper)

We propose that only individuals who:

- (a) are appropriately licensed/registered under the SFO;
- (b) 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; and
- (c) are not on the list of unacceptable individuals

may do sponsor work or IFA work.

Q.3 Do you agree with our proposal?

Yes

No

Please state reason(s) for your view.

While we agree with the proposal in general, we have reservation by including item (c) as one of the conditions or, at the very least, it needs to be further elaborated on the criteria of being regarded as "unacceptable individuals" before we can give a view on it.

As the establishment of unacceptable individuals is a very serious act, if the Exchange decides to maintain a list of unacceptable individuals, it should explicitly list out the "criteria" for assessment and establish an in-depth investigation and appeal mechanism. Otherwise, such a mechanism might be misused and

corporate finance practitioners might be unfairly penalized.

Moreover, such list of unacceptable individuals should not be made public on the HKEx website or any other media. The Exchange and/or the SFC can already effectively exclude all "unacceptable individuals" in their own "private" list from doing any IPO or IFA work.

Unless it was proven that the individual's integrity was in question, he or she should not be penalized for sub-standard work or negligence of a minor nature or other unacceptable behavior to warrant him or her to be exposed to the public scrutiny in addition to being blacklisted. They are not public figures like the Legco or Exco Councillors and the Exchange should not impose unnecessary public pressure on those individuals by making the list public.

In a nutshell, the list of unacceptable individuals being made public does not add any value on preventing "unqualified" individuals from doing sponsor or IFA work if the Exchange has already established such a list on its own.

CRITERIA FOR INCLUSION ON THE LIST OF SPONSORS AND IFAs

Competence and experience of the sponsor and IFA firms

(Paragraphs 60 to 66, 73 and 79 of Part B of the Consultation Paper)

We propose that the focus of our requirements will be on the experience of the individual member of staff, rather than the sponsor firm or IFA firm and that sponsor firms have at least four eligible supervisors and IFA firms have at least two eligible supervisors.

Q.4 Do you agree with our proposal?

Yes

No

Please state reason(s) for your view.

The employment of at least four eligible supervisors for sponsor firms and at least two eligible supervisors for IFA firms would ensure that adequate expertise would be available to sponsor firms and IFA firms to properly execute the engagement.

Qualification and experience criteria of eligible supervisors

(Paragraphs 67 to 79 of Part B of the Consultation Paper)

We propose to merge the requirements relating to qualification and experience criteria for Principal Supervisors and Assistant Supervisors into a single new category called "eligible supervisors". We also propose to recognize overseas experience derived from recognized overseas exchanges (such as NYSE, NASDAQ, SGX, ASX, London Stock Exchange and Toronto Stock Exchange) for the purposes of assessment of individuals. Accordingly, the experience requirement of the four eligible supervisors required in each sponsor firm is proposed to be as follows:

- must have a minimum of 4 years of relevant corporate finance advisory experience derived in respect of companies listed on recognized stock exchanges or from other channels, such as corporate finance experience gained from employment with an issuer listed on the Exchange;

- substantive involvement in at least 3 significant transactions, which have been completed. At least one of those transactions must be in respect of a company listed on the Exchange. At least one transaction must have been an IPO and at least one of the transactions must have been completed within the previous two years. These requirements will be on-going requirements.

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 of "significant transactions" is proposed to include: (i) IPOs; (ii) very substantial acquisitions or disposals (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iii) major transactions (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iv) connected and major transactions (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (v) a rights issue or open offer by a listed company (or their equivalent under the rules applicable to listing on other recognised stock exchanges); and (vi) takeovers subject to the Takeover Code (or its equivalent in other recognised jurisdictions). Guidance will be provided to clarify that transactions involving the production of an exempt listing documents and the listing of investment companies will not be regarded as significant transactions.

We propose that the qualification and experience criteria for the two IFA eligible supervisors in an IFA firm be the same as for sponsor eligible supervisors save for the one IPO transaction experience requirement.

Q.5 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

While we agree to merge the requirements in relation to the qualification and experience criteria for Principal Supervisors and Assistant Supervisors into a single new category of Eligible Supervisors that is applicable to both Mainboard and GEM and the initial admission criteria for Eligible Supervisors as stipulated above, we have the following comments in relation to Eligible Supervisors.

1. On-going requirements

Although we agree that a minimum benchmark, the number of significant transactions completed in this case, is required to assess whether an individual is qualified to become an Eligible Supervisor, we have strong reservation on the use of such benchmark as an on-going requirement.

Once being admitted as an Eligible Supervisor, a corporate finance practitioner has already demonstrated that he/she has accumulated the knowledge and experience necessary to manage a listing application and other corporate transactions. Similar to other professions, such expertise would not be obsolete in a short period of time and we are not aware of any other professions, such as lawyers and accountants, having such nature of on-going requirements. Instead, we suggest that the existing continuous professional training (CPT) be strengthened, so that Eligible Supervisors can keep abreast with market development and regulatory environment from time to time once the basic admission requirement has been met.

In addition, as the number of transactions a firm can procure and complete greatly depends on a number of factors such as market conditions, financial resources and size of the firm, the proposed requirement of having completed 3 significant transactions (including 1 IPO) on a continuous 4 years basis will be too demanding for relevant Eligible Supervisors to comply with on an on-going basis. As mentioned above, although we agree that a minimum benchmark should be set for corporate finance practitioners in the initial admission criteria, their eligibility should not be penalized if their firms cannot procure an unrealistic number of "significant transactions" to fulfill their on-going obligations if the market conditions are not favorable and the prevalence of certain other negative factors which are out of the control of those firms. Therefore, even if the number of significant transactions completed must be used as an on-going requirement for Eligible Supervisors, it must be set at an achievable and reasonable level.

2. Completed transaction

As part of the experience requirement for Eligible Supervisors, they must be substantially involved in at least 3 significant transactions, which have been completed. The term "completed" has not been defined. To avoid any confusion, we propose to define the term "completed transaction" as the transaction which its relevant circular, listing document or prospectus has been dispatched no matter whether the transaction can or cannot be completed eventually as sponsors and IFAs have already fulfilled their duties at the issue of such documents. For example, prior to the issue of the prospectus, sponsor should have already fulfilled its due diligence duties. Whether the issuer can successfully list on the Exchange depends mainly on market force. Similarly, due diligence work and relevant analysis have been fully made and completed by an IFA at the time when the circular is dispatched, and the completeness will not be affected whether the relevant resolution can be duly passed in the general meeting.

3. Significant transactions

Although UKLA has similar "significant transactions" requirements for eligible employees, the scope of significant transactions as defined by UKLA is much broader than that proposed by the Exchange. Therefore, we propose adding connected transactions that require voting in general meeting, privatization, debt restructuring and preparation of listing documents for further issues of shares as significant transactions.

Although the above transactions may be less complex in nature, we believe, by substantially involving in those transactions, a corporate finance practitioner can still gain the knowledge and experience necessary to manage the application procedures for a listing application in a competent manner and advise his clients on the application and interpretation of the Listing Rules in other corporate transactions.

Other factors relevant to the eligibility criteria

(Paragraphs 80 to 81 and 86 to 94 of Part B of the Consultation Paper)

We propose to retain discretion for the Exchange to refuse or cancel a sponsor's acceptance. The Exchange may ask a sponsor or prospective sponsor to provide further information during the assessment of their application. To provide clarity about the circumstances in which the Exchange may consider exercising this discretion we will publish details of the factors we will take into account in making an evaluation. The proposed factors include the following:

- The eligibility criteria requirements, including minimum capital, number of eligible supervisors, experience of individual eligible supervisors, are not met;
- The applicant is unable to satisfy the Exchange that it will be able to discharge the obligations in paragraph 7 of the proposed *Code of Conduct for Sponsors and Independent Financial Advisers* (these obligations include having effective supervisory, monitoring and reporting controls, an effective compliance function, adequate competence, professional expertise and human and technical resources and maintaining proper books and records);
- Current suspension or revocation of regulatory status (including where this is self-imposed as a result of settlement); and
- Suspension or revocation of regulatory status (including where this is self-imposed as a result of settlement) that has expired but in relation to which, the applicant is unable to satisfy the Exchange that appropriate and sufficient remedial steps have been taken.

We propose that the same factors be taken into account in determining the acceptability of IFAs as are taken into account for sponsors, save for the minimum capital adequacy requirement.

Q.6 Do you agree with our proposal?

Yes

No

Please state reason(s) for your view.

We believe the Exchange should retain discretion to refuse or cancel a sponsor's acceptance in exceptional circumstances as a final safe guard of our industry. However, a fair appeal mechanism has to be in place.

Minimum Capital Requirement of Sponsor Firms

(Paragraphs 82 to 85 of Part B of the Consultation Paper)

We propose that sponsor firms are required to meet and maintain a minimum capital requirement of "total paid-up share capital and/or non-distributable reserves of not less than HK\$10 million represented by unencumbered assets and a net tangible asset value after minority interests of not less than HK\$10 million". Should the sponsor firm be unable to meet the capital requirement, we propose to accept as an alternative an unconditional and irrevocable guarantee from a company within the sponsor group or an authorized institution of not less than HK\$10 million.

We do not propose that IFA firms should be subject to a similar requirement.

Q.7 (a) Do you agree with our proposal for sponsor firms?

Yes

No

Please state reason(s) for your view.

The establishment capital criteria would ensure that the sponsor firm has adequate resources to fulfill its role as a sponsor and the responsibility it accepts.

Q.7 (b) Do you agree with our proposal for IFA firms?

Yes

No

Please state reason(s) for your view.

As most of the IFA assignments generally require significantly less resources than listing exercises, IFA firms should not be subject to capital requirement.

Undertakings to the Exchange

(Paragraphs 95 to 97 of Part B of the Consultation Paper)

We propose that each of the sponsors and IFAs seeking to be admitted to the list of Sponsors or list of IFAs be required to declare that the contents of its application to be admitted to the list is true and does not omit any material fact. We also propose that each of the sponsors and IFAs seeking to be admitted to the list must sign an undertaking to the Exchange to comply with the relevant Listing Rules applicable to sponsors or IFAs, including the proposed Code of Conduct for Sponsors and Independent Financial Advisers; and to assist the Exchange with investigations, including by producing documents and answering questions fully and truthfully. Furthermore, we propose that eligible supervisors be required to provide the Exchange with a written undertaking in similar terms to that provided by sponsors firms and IFA firms. This will include an obligation to comply with the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. The proposed Code of Conduct for Sponsors and Independent Financial Advisers includes an obligation that the eligible supervisors and directors of sponsor firms and IFA firms use their best endeavours to ensure the sponsor firm or IFA firm complies with its obligations under the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. A breach of the undertaking will be deemed to be a breach of the Listing Rules and will be subject to disciplinary action.

Q.8 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

We consider that it is appropriate for the sponsor or IFA firms to provide the abovementioned undertaking. On the other hand, Eligible Supervisors should not be required to provide the Exchange with a written undertaking on his/her personal capacity in similar terms to that provided by sponsor and IFA firms.

Eligible Supervisors are only employees of the sponsor or IFA firms who, in general act as the agent of the sponsor or IFA firms to negotiate, coordinate and execute the corporate finance transactions undertaken by their employers. It is the responsibilities of the sponsor or IFA firms to closely monitor their agents during the process. It should be noted that it is the sponsor or IFA firm that forms a contractual relationship with the client for facilitating the completion of such transactions, not individual Eligible Supervisors. Therefore, if any undertaking is being required by the Stock Exchange in relation to the client, it should only be applied to the sponsor or IFA firms.

APPOINTMENT

(Paragraphs 98 to 113 of Part B of the Consultation Paper)

We propose to retain the requirement that new applicants (including deemed new applicants) will be required to appoint a sponsor to assist them through the application process.

After the new applicant is listed, we propose that:

- (a) For Main Board: the new applicant must appoint a sponsor firm as a financial adviser for a period ending on publication of the financial results for the first full financial year after the listing.
- (b) For GEM: the new applicant must appoint as sponsor firm as a financial adviser for at least the remainder of the financial year during which the listing occurs and the 2 financial years thereafter (i.e. we propose to retain the period stipulated in the existing GEM Listing Rules).

The issuer will not be obliged to appoint the same sponsor firm who handled their IPO. During this period, the issuer will be obliged to seek, on a timely basis, advice from the

sponsor in relation to a number of prescribed events. The prescribed circumstances and services are proposed to include the publication of any regulatory announcement; publication of any circular or financial report; where a notifiable transaction (connected or otherwise) is contemplated including share issues and share repurchases; and monitoring the use of the proceeds and adherence to the business plans as detailed in the prospectus.

We also propose to retain the discretion to direct an issuer to appoint a sponsor firm to provide it with advice for any period it specifies. This discretion may be used in the event of a breach of the Listing Rules or investigation of a possible breach of the Listing Rules.

We also propose to retain the requirement that listed issuers are required to appoint an IFA in relation to connected party transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain from voting. We will clarify that an IFA must be a firm either on the list of acceptable Sponsors or list of acceptable IFAs.

Q.9 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

The guidance and advice of a sponsor is valuable to new issuers before they can familiarize themselves with the on-going obligations of the issuers under the Listing Rules. As Main Board applicants are generally more established than GEM applicants, the sponsor retaining period for Main Board should be shorter than that of GEM.

INDEPENDENCE

(Paragraphs 114 to 123 of Part B of the Consultation Paper)

We propose that a sponsor must not act for any new applicant or listed issuer, whether as a sponsor or joint sponsor, from which it is not independent. The Exchange will expect a sponsor to consider a broad range of factors that might impact on its ability to act independently of an issuer. Some of these factors are considered below, but sponsors should note that this list of factors of when a sponsor will not be regarded as independent is not exhaustive and the existence of other relationships or interests which might give rise to a material interest in the success of a transaction will be considered. The specified circumstances are:

- a sponsor or any member of the sponsor's group is holding more than 5% of the issued share capital of a new applicant;

- the fair value of shareholding referred to above exceeding 15% of the consolidated net tangible assets of the sponsor group;
- a sponsor or any member of the sponsor's group is controlling the majority of the board of directors of the new applicant;
- a sponsor is controlled by or is under the same control as the new applicant;
- 15% or more of the proceeds raised from an IPO is applied to settle debts due to a member of the sponsor's group;
- a significant portion of the listing applicant's operation is funded by the banking facilities provided by a member of the sponsor's group;
- where a director or employee of the sponsor or a close family member of either a director or employee of the sponsor has an interest in or business relationship with the new applicant; and
- where the sponsor or a member of the sponsor's group is the new applicant's auditor or reporting accountant.

In addition to fulfilling the independence requirement as mentioned above, we also propose 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 its connected persons any significant assignment within two years of appointment.

We also propose to require sponsors and IFAs to submit a declaration in respect of their independence, addressing each category of potential conflict, at the beginning of any assignment, which requires the appointment of a sponsor or an IFA.

Q.10 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

While we support that sponsor and IFA firms should be reasonably independent from their clients and generally agree with the specific circumstances as set out above, some of them are unclear and may cause sponsor and IFA firms (especially those with multinational operations or shareholders involving in a wide

range of businesses) problems in ascertaining their independence. Therefore, we hope the Exchange could clarify the following:

1. Sponsor's Group

We wish the Exchange to define the meaning and scope of this term (possibly by shareholding percentage) so that sponsor firms will have a clear idea on which entities will be considered as members of the sponsor's group. We suggest that members of the sponsor's group be defined as any company that would be defined as an associate of the sponsor under the Listing Rules. We also wish the Exchange can specify whether sponsor can receive shares of its clients as part or all of the sponsor's fee.

2. A sponsor is controlled by or is under the same control as the new applicant

We hope the Exchange can specify the effective percentage shareholding of the term "control" in the above sentence is referring to over 30% or 50%.

3. Where a director or employee of the sponsor or a close family member of either a director or employee of the sponsor has an interest in or business relationship with the new applicant

We wish the Exchange could specify the effective percentage shareholding of the term "interest" in the above sentence. We suggest that 5% effective shareholding be taken as the benchmark in the new applicant.

4. Significant assignment

We hope the Exchange can define what transactions or services would be considered significant assignment. For example, if the director of a listed issuer has an active trading account in the securities trading arm of an IFA firm, would the trading activities be considered as significant assignment?

RESPONSIBILITIES

Reasonable investigations

(Paragraphs 124 to 152 of Part B of the Consultation Paper)

We propose that the Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that:

- 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;

- “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; and
- 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.

We propose that sponsors be required to comply with a Code of Conduct that will set out, among other things, the minimum due diligence a sponsor would be expected to undertake to satisfy the obligations to conduct reasonable investigations we propose including in the Listing Rules.

We propose that the Main Board and GEM Listing Rules be amended to require IFAs:

- to take all reasonable steps to satisfy themselves that 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 and that there are no grounds to believe that any expert advice or opinion relied on in relation to the transaction are not true or omit a material fact; and
- to make a declaration in their report of the due diligence they have performed in order to reach a conclusion that the terms of the relevant transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole.

Q.11 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

Regarding sponsors responsibilities, we have the following comments:

1. *It is proposed that "The Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that the new applicant and its directors can be expected to honour their obligations under the Exchange Listing Rules and the Listing Agreement".*

We are of the view that "investigation" is an inappropriate word as stipulated in the statement above, which means to inquire, examine, inspect, probe and scrutinize. Although we believe most new applicants and their directors have no intention to breach their obligations under the Exchange Listing Rules and the Listing Agreement at the time of their listing application, no matter what "investigations" are conducted by sponsors on the directors of issuers, sponsors are not in a position to predict their future acts. Sponsors can only take reasonable steps such as providing directors' training or guidelines to make directors aware of their obligations. Therefore, it is impossible for sponsors to satisfy themselves that the new applicant and its directors "can be expected" to honor their obligations under the Exchange Listing Rules and the Listing Agreement. Sponsors should not be penalized for something out of their control.

Accordingly, we suggest the following amendment:

"The Main Board and GEM Listing Rules be amended to require sponsors to take reasonable steps to satisfy themselves that the new applicant and its directors are made aware of their obligations under the Exchange Listing Rules and the Listing Agreement"

2. *It is proposed that "The Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that "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 agree that reasonable investigations should be carried out by sponsors in relation to the " non-expert sections " of listing documents.

3. *It is proposed that "The Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that*
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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".

Again, we are of the view that "investigation" is an inappropriate word as stipulated in the statement above. Sponsors are not in a position to "investigate" the work-done by experts relating to accountants' reports, legal opinions and/or valuation reports and certainly are not capable of "investigating" every detail of the work conducted by each of the experts. The listing process should be a kind of collaborative effort/responsibilities by all relevant parties (including the issuers). Sponsors should not be isolated and penalized for any malpractices made by any of the parties involved in the listing process.

As such, we consider that sponsors are not in a position to form any opinion on the "expert sections" of the listing document. Therefore, we suggest deleting the responsibility statement regarding "expert sections" above.

4. Overall responsibilities

We hope the Exchange can understand that Hong Kong is already facing keen competitions from countries such as Singapore for being a leading financial market. Any unnecessary compliance burden on sponsor firms, such as investigating the work done by other professional experts as set out in the "expert sections" of the listing document, will have detrimental effect on the competitiveness of the Hong Kong market. As stated in the consultation paper, the focus of the Exchange's review is on the adequacy of disclosure and ensuring that an applicant meets a number of prescribed initial listing criteria, which, in our view, should not include regulating the scope of work performed by each party involved in the listing process. The Exchange should evaluate the balance between the depth and breath of compliance and market developments before imposing any of the regulation proposed in this consultation paper.

As regards our opinion on the Code of Conduct and the report of due diligence from IFAs, please refer to Q. 12 and Q. 15 respectively.

CODE OF CONDUCT FOR SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

(Annex 2)

At Annex 2 we set out the proposed Code of Conduct for Sponsors and Independent Financial Advisers.

Q.12 Do you agree with the approach adopted in the proposed Code of Conduct for Sponsors and Independent Financial Advisers?

Yes

No

Please state reason(s) for your view.

We believe the Code of Conduct for Sponsors and Independent Financial Advisers should only be observed by sponsor firms, IFA firms and Eligible Supervisors as a general reference for best practice but not be included as part of the Listing Rules since the Code only contains a set of guidelines and procedures that should not be treated as rules or regulations. Furthermore, we have not been requested to give our views on the contents of the Code, but we think that consultation is necessary from practitioners given that certain provisions in the present draft are far from realistic or too onerous for practitioners to comply with. For example, the Code included quite a number of absolute wordings such as "completely independent" and "does not have any relationship" and open-ended wordings such as "include but not limited to" that are neither measurable nor enforceable.

Moreover, as stated in the consultation paper, the focus of the Exchange's review is on the adequacy of disclosure and ensuring that an applicant meets a number of prescribed initial listing criteria, which, in our view, should not include regulating the scope of work performed by each party involved in the listing process as stipulated in the Code.

Many of the requirements as stipulated in the Code are too onerous and need further refinement before they can be included in the Code, in particular:

20. It should be the responsibility of lead underwriters, not sponsors (who may or may not take part in underwriting or they simply do not take any role in underwriting), to check the credentials of their sub-underwriters and placement agents.

24(b): As stated in our response to Q11 above, sponsors are not appropriate to duplicate or second-guess the works carried out by experts and are certainly not in position to assess the integrity of financial information provided by the issuer's accounting staff, internal or external auditors.

25(b): As stated above, sponsors are not in the position to determine the scope of work to be carried out by experts

25(e). It should the responsibilities of the expert or professional to confirm

its independence. We would like to reiterate that listing is a collaborative work of all parties involved.

30bii: Again, IFAs, similar to sponsors, are not in the position to assess the appropriateness of the scope of work of experts.

33(a): The use of "must not have any other business relationships" in this point is impractical. For example, if the director of an issuer has an inactive account in the securities trading arm of an IFA firm, will this affect the independence given the present "absolute" wordings?

33(b): It is highly unlikely that all 4 of the Eligible Supervisors in a sponsor firm will engage the same IFA job together. As long as the sponsor firm and the Eligible Supervisor responsible for the IFA job have not acted as corporate finance adviser of the issuer in the two years prior to appointment, there is no reason to exclude them from doing such IFA job.

In addition to the above, we do not agree that a set of minimum review procedures should be established to govern the due diligence carried out by sponsor and IFA firms.

Currently, we understand that, among other exchanges mentioned in the consultation paper, only the Toronto Stock Exchange, which primarily consists of mining and resource companies, has established minimum review procedures for sponsors (not including IFAs). Hong Kong, as in the case with other leading financial markets, has vast varieties of listing candidates with different businesses, mode of operation and geographic locations. Therefore, we believe it is not possible to establish a "minimum due diligence" standard applicable to all of them.

We believe sponsors firms, IFA firms and their Eligible Supervisors would set up their own rigorous standards to ensure appropriate level of due diligence to be done and it would be restrictive to define the minimum review procedures that are supposed to apply to all listing applicants and listed issuers. In addition, the Exchange might advocate sponsor firms and IFA firms to establish their own societies to administer self-regulatory matters as practiced by most other professions such as accountants and lawyers.

Declaration by sponsors and lead underwriters in listing documents to be registered
(Paragraphs 153 to 165 of Part B of the Consultation Paper)

We propose that both sponsors and lead underwriters (where the latter are different from the former) should make a statement in listing documents regarding the extent of their due diligence which would track the form of statement currently given to the Exchange on a private basis by sponsors subject to the modification noted below. A sponsor is also expected to ensure that the document presents a fair impression of the issuer and that it has been written in plain language. The sponsor's due diligence obligation is modified in respect of reports and information published in a listing document with the consent of an expert. The form of declaration proposed recognises this distinction. In respect of "non-expert sections" of a listing document we propose that the following statement should be made "[Sponsor firm and underwriter] confirm(s), at the date of this document, that after reasonable investigation it believes/they believe and have reasonable grounds to believe that the information set out in this listing document at [make specific references] is not materially false or misleading" and, in respect of "expert sections", an alternative test of due diligence that "it/they have no grounds to believe and do not believe that the information set out in those sections of the listing document at [make specific references], which have been prepared and authorised by [name], is materially false or misleading".

Q.13 Do you agree with our proposals?

- Yes*
- No*

Please state reason(s) for your view.

We believe that the quality of issuers is the major concern of the Exchange and investors. If sponsor firm, after reasonable due diligence, has already made the declarations as suggested above, there is no reason to believe that the addition of another party to repeat the same can improve the quality of the issuer further. We hope the Exchange can elaborate the rationale behind this proposal.

IFA Due Diligence Declaration

(Paragraph 147 of Part B of the Consultation Paper)

We propose that IFAs are required to take all reasonable steps to satisfy themselves that 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, and 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. IFAs should include in their reports a signed declaration setting out the due diligence they have performed in order to reach a conclusion that the terms of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole.

Q.14 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

In most cases, IFAs would set out the due diligence they have performed, including the documents and information reviewed, analysis performed and comparisons made, in order to reach a conclusion that the terms of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole in their IFA letter.

We believe IFAs have sufficiently discharged their responsibilities through existing practice and should not be required to submit a separate due diligence report.

REPORTING OBLIGATIONS AND MONITORING

(Paragraphs 166 to 170 of Part B of the Consultation Paper)

We propose to replace the requirement for an annual review with a certification process and a targeted programme of monitoring.

We propose to require sponsor firms and IFA firms and their eligible supervisors to submit annual confirmations that they remain eligible to act in such capacity. In addition, they are required to report to the Exchange as soon as they became aware if they no longer satisfy the eligibility criteria set out in the Listing Rules or any information provided by them in connection with their application or continued inclusion on the list of Sponsors or the list of IFAs has changed. The Exchange may also conduct a specific review in relation to the

continued inclusion of the sponsor firm or IFA firm (or any of its employees) if it becomes aware or has reason to believe that the suitability of the firm/individual may be in question.

The monitoring tools we propose to use will vary according to circumstances and may include one or more of the following:

- Complaints;
- Desk based reviews of transactions;
- Reviews of referrals;
- Liaison with other agencies, professional or regulatory bodies;
- Meetings with management and other representatives from a sponsor firm or IFA firm;
- On-site visits after prior notification;
- Reviews of notifications and confirmations from sponsors or IFAs; and
- Reviews of past services provided, and documentation produced, pursuant to the Listing Rules by a sponsor or an IFA.

Q.15 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

With this new process, the eligibility of sponsor firms and IFA firms can be monitored by the Exchange timely and efficiently, which is in the interest of the industry. To ensure fair and unbiased monitoring, we suggest that the approval, review and appeal procedures should be performed by separate groups in the Exchange.

COMPLIANCE AND SANCTIONS

(Paragraphs 171 to 181 of Part B of the Consultation Paper)

We propose that sponsors and IFAs and their eligible supervisors and staff all be subject to disciplinary sanction. As noted in paragraph 54 we do not propose having a list of acceptable directors and individual staff members who are not eligible supervisors. Thus, all persons licensed as representatives to advise on corporate finance will be entitled to do sponsorship or IFA work under the supervision of an eligible supervisor, unless they have been declared to be an unacceptable person.

We propose disciplinary sanctions for sponsors and IFAs similar to those under the current GEM Listing Rules, but with some variations for individuals. As with our sanctions for issuers and directors, we propose a graduated hierarchy of shaming and disabling sanctions that provide the flexibility to ensure the sanction is appropriate to the circumstances. Our proposed sanctions are:

- Private reprimand;
- Public statement with criticism;
- Public censure;
- Declaration that an individual is an unacceptable person or cannot be an eligible supervisor for a specified period of time;
- Suspension of a firm from the list of acceptable sponsors or list of acceptable IFAs for a specified period of time;
- Declaration that an individual is an unacceptable person or cannot be an eligible supervisor; and
- Removal of a firm from the list of acceptable sponsors or list of acceptable IFAs.

Q.16 Do you agree with our proposals?

Yes

No

Please state reason(s) for your view.

We support all of the proposed sanctions above except the establishment and publication of the list of unacceptable individuals. Please refer to our comments in Q.3 for details.

ABILITY OF EXISTING GEM AND MAIN BOARD SPONSORS AND IFAS TO MEET ELIGIBILITY CRITERIA FOR ACCEPTABLE LISTS
(Paragraphs 186 to 189 of Part B of the Consultation Paper)

For those respondents to this Consultation Paper who are currently on the list of GEM Sponsors or who currently perform or who have in the past 2 years performed work as Sponsor to Main Board applicants for listing or have in the past 2 years acted as an IFA, we would appreciate your response to the following questions:

Q.17 Would you meet the proposed eligibility requirements for sponsor firms or IFA firms (whichever is applicable), including the requirement that sponsor firms have four eligible supervisors and HK\$10 million capital or that IFAs have two eligible supervisors if those requirements:

(a) *were in effect today?*

Yes

No

(b) *were in effect in 6 months time?*

Yes

No

(c) *were in effect in 18 months time?*

Yes

No

(d) *were in effect in 30 months years time?*

Yes

No

Q.18 If your answer to any of questions 17 (a)-(d) was negative, please state which criteria would cause your firm not to meet the requirements and comment on whether the proposed transitional arrangements would give you a sufficient opportunity to meet all the requirements? Would this change if the second transition period (in which existing GEM sponsors would only be required to have 3 eligible supervisors to be on the list of acceptable sponsors) was 2 years instead of 1 year? Do you have any other suggestions or comments on how to address the issues arising out of the impact analysis at paragraphs 186 to 188 of Part B of this Consultation Paper?

Eligible Supervisors

After the transitional period, it is proposed that, among other requirements, a sponsor firm must retain at least 4 Eligible Supervisors in order to be included in the list of sponsors. Since additional time is required to recruit replacement, it will be difficult for sponsor firms to hire immediate replacements if one or more Eligible Supervisors leave.

To ensure sponsor firms temporarily without sufficient Eligible Supervisors can remain in the list of sponsors, we propose to provide these sponsor firms with a grace period of 6 months so that they will have enough time to appoint suitable replacements.
