ANGLO CHINESE
CORPORATE FINANCE, LIMITED

財務顧問有限公司 英高

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Private and confidential

31st July, 2003

by fax and hand

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

Fax no.: 2295 3597

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

Fax no.: 2810 5385

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Dear Sirs,

Response to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers

Thank you for inviting us to comment on the consultation paper. Since we think that there are many issues of both principle and detail to be addressed, we thought it would be helpful to set this out in detail separately from the questionnaire. Our detailed written response and the completed questionnaire are enclosed with this letter.

Overall, we are supportive of sensible and fair arrangements to improve the quality and performance of sponsors, the work of other professional firms engaged in preparing companies for listing and the prospectuses issued in Hong Kong. However, we believe this should be conducted in the context of improvements in the manner in which regulation takes place and the conduct of disciplinary proceedings. Further, the standards to which sponsors and other professional firms are supposed to adhere should be clearly articulated and their responsibilities carefully defined so that they can have the confidence that with reasonable endeavour these standards can be met. Any arrangements must also recognise the difficulties inherent in issuers from less developed economies.

On the other hand, we are not supportive of arrangements which make sponsors responsible for the action of others, including directors and other professional advisers to a listed issuer, ask sponsors to provide confirmations which they are not competent or qualified to make or which fail to define accurately what is required and the practical steps that can be taken to achieve the required standards. We are also adamantly opposed to the introduction of the dual regulation of our business by both the Stock Exchange and the SFC which is unnecessary and wasteful.

However, before proposals are put forward to achieve the objectives articulated in the Consultation Paper, we believe that a number of issues of principle need to be addressed. In

40th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong.
Telephone: 2845 4400 Facsimile: 2845 1162 e-mail: accf@anglochinesegroup.com

summary, these are:

- who should regulate sponsors and what resources and capabilities should they have;
- what work should sponsors realistically be expected to be responsible for;
- what are the practical limitations of due diligence and verification;
- what reliance the regulatory authorities should place on confirmations by sponsors on matters on which it is known they are not qualified to give an opinion or matters which are obviously beyond their knowledge;
- how active should the Listing Division and the SFC be in the vetting of company documents;
- what information can an IFA be expected to rely on;
- how conflicts of interest can be addressed? This is particularly pertinent with the accounting profession and their corporate finance affiliates and when accounting firms are appointed to advise a company at the insistence of its bank creditors. Conflict of interest also needs to be addressed in disciplinary proceedings brought by the Listing Division concerning work on a prospectus which has been subject to extensive vetting by the Listing Division;
- how sponsors, underwriters and others are regulated in practice elsewhere? We do not believe the proposals taken as a whole would be acceptable in any of the jurisdictions covered in the Consultation Paper;
- the present workings of the Listing Division and the Listing Committee;
- the composition of the Listing Committee and its experience and working knowledge of the Listing Rules; and
- the practicality and fairness of a code of conduct on sponsors.

Lastly, we understand that you may publish responses on your websites. If this is the case, please let us know in what form and context you propose to publish responses. Subject to being satisfied by this, we would have no objection to this letter and its enclosures being published.

ANGLO CHINESE 美高

We would like to thank you for giving us the opportunity to respond to your consultation paper. Should any matter we have raised require further explanation, please let us know.

Yours faithfully,
For and on behalf of
Anglo Chinese Corporate Finance, Limited

Stephen Clark	Christopher Howe	Dennis Cassidy
Managing Director	Managing Director	Director, Head of Corporate Finance

SEC/CJH/DC/cw

[Cecilia/Exchange/ltr to Ex & SFC]

Detailed Response to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers

Overall comments

First we would like to make a number of general comments and then comment on various paragraphs of the consultation paper and the proposed Code of Conduct for Sponsors and IFAs.

A. Requirement to improve the disciplinary procedures of the Exchange

If this new policy is to be administered by the Exchange, as a matter of urgency the Exchange must improve the standards and procedures adopted by its Listing Committee for review and disciplinary proceedings. These improvements should be in place before it extends its supervision of sponsors and IFAs. In this regard, the procedures and the composition of the Takeovers Panel would serve as a useful model.

In particular, the Exchange should:

- adopt procedures which enable parties to have either legal or financial advisers make oral submissions on their behalf;

- be consistent in its approach so that the perception that large influential concerns are treated more generously is dispelled;

- make every effort to prepare objective reports to the Listing Committee. In our experience, it is not unusual for a case to be made based on an error or errors of fact, an occurrence which does not appear to have troubled the Listing Committee. Lack of objectivity and errors of fact may be a product of the inherent conflict of interest that arises when the Listing Division is prosecuting matters in which it has played a prominent part from the outset;

- ensure that Listing Committee members are properly prepared in advance of a hearing and confirm that they have carefully read the papers circulated to them;

- ensure, when reviewing Listing Division decisions concerning the interpretation of the Listing Rules and in disciplinary matters, that a majority of the members of the Listing Committee hearing the matter are or have been professionally involved in advising listed issuers on the interpretation of, and compliance with, the Listing Rules. As a matter of practice, this is generally how the Takeovers Panel is constituted; and

- most importantly, publish written decisions, giving the full reasons for the decision, in the same manner as the Takeovers Panel. Without this, the standards expected of sponsors will never be properly policed or articulated. It also provides a discipline to arrive at logical and consistent decisions.

As matter of principle, we believe that the authority which registers corporate finance

advisers should conduct any disciplinary action taken against sponsors or IFAs. Properly, it should be the SFC which should administer any disciplinary proceeding. It also has a much more effective and fairer appeals procedure than the Exchange. This may be more pertinent if the Exchange loses its listing function. The SFC has a statutory obligation to maintain standards and it should not abrogate them to a commercial enterprise.

Further, until a disciplinary decision has been reached, the Exchange should not be permitted to anticipate a decision by withdrawing its cooperation to a sponsor or the issues it may be handling.

B. Improvement of the quality of the Listing Division

If the Exchange is to be given greater powers of discipline and the underlying objective of the policy set out in the Consultation Paper of improving standards is to be achieved, it is essential that the Exchange's Listing Division substantially raises its own standards. This improvement should be evident before it is given greater powers of regulation, investigation and discipline.

C. The limitations of due diligence and reliance on others

It should be accepted at the outset that no verification procedure or due diligence can counter fraud. Further, a sponsor should be permitted to rely on the work of the other professional firms involved. In particular, it should place complete reliance on qualified or unqualified audited accounts, title searches, registered trade marks, professional property and vessel valuations and the verification procedures adopted by its lawyers. No sponsor in Hong Kong is in a position properly to review the work provided by these professionals.

D. Regulation cannot eliminate risk

Further, it should be accepted that no kind of regulatory regime in Hong Kong or elsewhere can eliminate China risk. We would be wholly opposed to a policy which punished advisers in Hong Kong for the shortcomings of others, particularly when they are outside the reach of the regulatory authorities in Hong Kong.

E. The parties to a prospectus should face the same disciplinary process

The regime should be fair and reasonable and the penalties for poor performance should be equally applied. The listing process is a coordinated effort by a number of professional and other firms. Sponsors should not underwrite the work of the other professionals involved in a transaction. Punishment for a failure to perform the work to the required standard should be the same, regardless which party is at fault. We are not convinced that the disciplinary procedures of the auditing and legal profession, which have never to our knowledge found against a major firm in a listing matter, provide for equality of treatment. Sponsors risk being singled out for punishment which as a matter of principle is unfair. They are also the only party to a listing document which is subject to regulation and discipline by a statutory body. Other parties are subject to self-regulation, which is likely to be less demanding.

F. Causes for the decline in the standard of prospectuses

Recognition should also be given by the Exchange and the SFC that the invasive and lengthy vetting of documents has greatly reduced the quality of prospectuses in Hong Kong. Most are unreadable and fall well below an international standard, which reflects very poorly on Hong Kong. The vetting process has introduced further risk in documents being inaccurate or poorly prepared for the following reasons:

- for most issues the vetting process takes months (recently in one of our issues, first round comments were received after seven weeks of lodging a substantially completed draft prospectus which is twice the length of time the whole vetting process is supposed to take). It, therefore, becomes a contest to get the document cleared. All energy is directed to obtaining clearance, possibly at the expense of the continuing accuracy of a document. Further, effort is diverted to the clearance process which would be more productively used elsewhere, including the due diligence process;

- nobody can be expected to invest their time and creativity in producing a well written and researched description of a company to expose it to a mauling of hundreds, largely irrelevant, comments by the Stock Exchange and often comments from people who are underqualified to make them. The prevailing attitude is that, since a draft is to be spoilt anyway, why take any trouble over it;

- a useful model for helpful, readable prospectuses is Australia which combine essentially a company brochure which is much shorter than the description of a business in a Hong Kong prospectus with the statutory information in two separate parts. It would be impossible to produce such prospectuses in Hong Kong as any attempt would be peppered with requests for further information and injunctions to "expand" and "clarify". Prospectus should be more focused and description should distinguish between what is material and what is not. This is not presently the case;

- the vetting system positively discourages redrafting. This is unfortunate as it precludes a sponsor improving the text of a prospectus, except when redrafting is absolutely essential. A redrafting is simply an invitation for a further battery of largely unnecessary questions; and

- the system has also encouraged sponsors to be lazy, relying on the hundreds of questions and comments directed towards a prospectus to uncover problems. The active involvement of the Exchange in the production of a prospectus also reduces its ability to sanction the performance of sponsors. In effect, the extent of the involvement of the Listing Division in the drafting of prospectuses is so great that it is not credible for it to criticise sponsors if some subsequent defect is apparent in the document. Whatever oversights fooled the sponsor also fooled the meticulous, if misdirected, scrutiny of the Listing Division.

We would add that the Listing Division's approach is not consistent with international practice [as claimed in paragraph 19]. We know of no international exchange which adopts this approach to vetting.

G. The SFC and the Exchange should decide what kind of prospectuses they want and create conditions to encourage their production

We have already mentioned Australia as a suitable model for prospectuses. We fear, however, that the proposals set out in the Consultation Paper are much more likely to lead to United States style prospectuses, which are drafted primarily by lawyers to protect their clients. This circumscribes what is said in a prospectus and how it is said. In view of this, we wonder whether it is desirable to replace the turgid, overly long Hong Kong style prospectus for the bland and, often unhelpful, prospectuses routinely produced in the United States, with an absence of any forward looking comments unless they are extensively qualified. From what we can see there is no encouragement whatsoever to producing well written, useful descriptions of a suitable length of a business.

H. The heart of the problem with PRC issues often lies in the accounts

We would regard the most worrying trend in PRC new issues as being the integrity of their published results. From the early days of "H" share issues, pre-issue group reorganisations and changes to the basis of accounts have had a substantial impact on the apparent profitability of the group to be listed and often precludes a proper assessment of the group's real underlying profitability. The trouble is that problems which have been eliminated from the track record and the accountant's report tend to flow back in subsequent years, as the parent is usually wholly reliant on its listed subsidiary as a source of discretionary cash flow. Obviously, as a number of scandals unfold, the reliability of the published audited information, usually in unqualified form, is becoming a more pressing issue. We do not think that it is a practical approach to shift the responsibility for the preparation of accounts from the auditors to a sponsor and further to agree to arrangements which prevents the Exchange taking any disciplinary action against auditors, but not sponsors. Such an approach, in our view, is misdirected, arbitrary and unfair.

I. Duplication of regulation

We note that the Exchange proposes to give itself wide powers of inspection of sponsors and IFAs. We find it objectable that our business is to be subject to regulation by two regulators, both of which can investigate our work whenever they wish. This duplication is wholly unnecessary and the power of investigation and monitoring the performance of sponsors should remain solely with the SFC. We see no merit in a dual regulatory system of the kind proposed.

J. Potential conflict of interest

The Exchange sees itself as a victim of misconduct which gives rise to breaches of its Listing Rules and more specifically the Listing Division will be involved in the investigation of such breaches. These factors, together with its desire to address complaints of aggrieved shareholders, place the Exchange in a position which makes it difficult for it to approach the matter with the appropriate level of impartiality and independence. Its interest in the outcome and previous involvement, we submit, fails to meet the standards of independence it requires from sponsors and financial advisers.

Specific comments on the consultation paper

We understand the consultation paper is in part the product of informal discussions with, amongst others, organisations engaged in listing work and the provision of independent financial advice. We consider that our firm is one of the largest and the most experienced such organisation, headquartered in Hong Kong, and obviously regret that our input will be confined to a consultation of a "wider audience". In this regard, we are particularly concerned with the absence of a proper industry consultation on the proposed Code of Conduct (see separate section below).

19. The vetting procedure is not consistent with international practice. Far from it.

20. We agree. The close proximity of the sponsor does mean it has a superior access to information.

22. This is an inaccurate description of the declaration made by sponsors and gives the impression that there is a more onerous duty imposed on sponsors than currently reflected in the Listing Rules.

23. The statement that the listing process is efficient and effective is a delusion. It is cumbersome and very slow. Recently, even before the requirement for dual filings, it has become much slower. There has been no streamlining since 24 July, 2004, quite the reverse.

24 Documentation deadlines are seldom met as the vetting process takes so long. Whilst we accept that the Listing Division does not accept responsibility for prospectuses, its vetting process has had a profound and detrimental effect on the quality of prospectuses. It cannot escape responsibility for this.

25. It is a pity that we do not move directly to a post vetting regime. This is likely to improve prospectuses and the performance of sponsors "out of sight". Australia would provide a useful model for this as well.

26. We have seen no evidence of the new policy whatsoever.

27. The Exchange is aware of the difficulties in verifying information in China. While sponsors should be on guard for the additional risks of Mainland issuers, the Exchange cannot expect sponsors to underwrite the "China" risk inherent in these issues. The method it proposes will not work, except in the limited sense of reducing the ranks of sponsors or unfairly punishing them. If the Exchange is prepared to accept Mainland companies for listing, it will have to accept that they carry considerably greater risks given the stage of development of its economy, law, and professional and regulatory framework.

28. As far as we are aware, except for easing the requirements for share option schemes (a retrograde and undesirable step for the investing public in our view), nothing came of this lengthy consultation by the Exchange.

32. The Exchange already possesses adequate disciplinary sanctions against errant sponsors.

It can stop their business. It has certainly instituted disciplinary proceedings against sponsors in the past. The Exchange cannot blame sponsors for its failing to use its disciplinary powers effectively. Even if the Exchange does not think it has adequate disciplinary powers, the SFC certainly has such powers which it can exercise if it believes a sponsor has failed to perform properly.

41. The problem here is the Exchange is singling out one category of adviser for special disciplinary treatment. This is neither fair nor reasonable. It would be interesting to know whether the arrangements with lawyers and accountants referred to have been acted upon and are considered to be satisfactory.

42. If the question of the extension of prospectus related liability is being considered by the Standing Committee on Company Law Reform, its conclusions should not be pre-empted by these proposals.

49. We question the competence of the Exchange, as it is presently staffed, to monitor effectively sponsors and IFAs. The detailed comments in this summary section are dealt with below. However, under the heading "Monitoring" we would ask the Exchange to explain what is meant by adopting a "risk based approach".

52. Registration as a sponsor or IFA should properly be supervised by the SFC. Would for example, an IFA employed to give advice in connection with a takeover have to be registered with the Exchange, even though the regulation of takeovers is an SFC matter? ✓

54. If the Exchange is proposing to have a list of ineligible persons, it may consider improving the information it provides on disciplinary matters generally. All disciplinary decisions should be available on its website, catalogued by which rules have been breached. This is not currently the case. Moreover, the information should go back further than 1999. ✓

57. It is quite apparent that the proposals will lead to unnecessary duplication of work in monitoring the performance of corporate finance advisers. Logically, the supervision of corporate finance advisers and sponsors should be under the SFC as it is part of its statutory function.

59. It appears from the report on the "Penny Stock Incident" that the cooperation between the Exchange and the SFC is not wholly satisfactory. The consultation paper should elaborate on what "suitable arrangements" are being put in place to "deal with enforcement cases of mutual interest".

63. We also agree that the focus should be on those working in a firm, rather than the firm itself. ✓

64. We agree. Often co-sponsors do little and the experience should not count for much when assessing eligibility for full sponsorship. We find it most unusual for the Exchange to deal with a co-sponsor in preference to the sponsor. It must be indicative of something amiss and we are surprised it permitted this state of affairs to continue. ✓

70. We agree. The title of employees should not matter.

76. Presumably IPO's will include any new listing, however it is achieved. For example, a listing by way of introduction where no new funds are raised.

81. Capital adequacy for sponsors. We agree.

82. Minimum capital should be able to be represented by subordinated shareholders' loans as it is for licensing purposes with the SFC or by the share capital of the parent company.

91. The reporting requirement to the Exchange will cause unnecessary duplication.

105, 110 and 113. We have no objection to the extension of the requirement to retain a sponsor after listing to Main Board companies. Would there be value in requiring a company to employ a sponsor, if there were to be a change of control and the new controllers had not controlled a listed issuer in Hong Kong or a major international market before? This is a different issue to deemed new listings [see 107].

110. Regardless of the directions of the Exchange, there may be circumstances when no sponsor will be prepared to act for a company in this event.

113. Advice on the application or interpretation of rules presents difficulties for a sponsor when sometimes the application of rules by the Listing Division or when the Listing Division or the Listing Committee or both make rulings which run counter to the natural meaning of the words used. In a recent case handled by our firm we found the Listing Committee's decision to be entirely contrary to the words used and obvious intent of the Listing Rules. In such circumstances, it is difficult to see how sponsors could possibly provide advice as to the "application or interpretation of the relevant Listing Rules with care and skill". We would also add the provision of guidance by the Listing Division in our experience is often not given when requested, or, if given, is often a lengthy process, which discourages guidance and advice being sought.

119. This is likely to be fiercely opposed by the major commercial banks with active investment banking operations but we believe it is consistent with the requirement of independence.

122. Acting as a financial adviser should explicitly exclude acting as an IFA.

130. This is an extraordinary paragraph. A written confirmation from the new applicant that figures has been properly extracted from accounting records is pointless and provides no comfort at all to anyone. What kind of due diligence does the Exchange expect a sponsor to undertake on the work of reporting accountants, lawyers and valuers? Should it appoint its own? Should it commission another audit? Surely a sponsor must place reliance on the work of other professional firms. There are no steps a sponsor can take to "ensure", that is "to make sure, warrant, guarantee" [see Shorter O.E.D.] that information provided by directors and other professional advisers is true, accurate and complete. All sponsors will automatically fail this standard. Lastly, we need to know what this due diligence questionnaire looks like.

133. Some statements have to be taken at face value as they cannot be confirmed by a third party enquiry. For example, no verification or due diligence process can be expected to,

or be, certain to identify undisclosed liabilities.

136. We agree. We find that many IFA letters are absurd and should cause concern to the SFC in its grant of licences.

140. We agree. The standard must be "reasonable care" and "reasonable investigation".

142. The United States does not provide a good example for forward looking statements. They seldom, if ever, appear in offering material. Profit forecasts never appear. However, the SFC and Stock Exchange must accept if there are United States style sanctions, prospectuses will look very like United States prospectuses, which are designed to avoid litigation and provide a bland boiler plate description of a business which is of little value to an investor.

143. We absolutely agree that it is essential to question third parties such as customers, suppliers and distributors. This works in Hong Kong. The value of such an enquiry may be rather less in China, particularly where industry statistics are often unavailable, unreliable or out of date.

144. There must be a concept of "reasonable reliance on officers and employees".

145. In many instances it is impossible to "positively satisfy [oneself] of the truth and completeness of non-expertised statements". The way a United States prospectus avoids this difficulty is to never make a statement which cannot be "positively proved", unless it is suitably qualified. However, the price for this is to greatly reduce the informational value of a prospectus. We do not believe that any one would really wish to replace our unreadable prospectuses for the anodyne prospectuses of the United States. A prospectus, properly, should be a marketing document, not a formal document which enables an issue to be made, when the marketing material (which is largely unregulated) is separately prepared.

146. A declaration by a sponsor that it expects directors to honour their obligations in the future is valueless. No sponsor can underwrite the future or anticipate that someone will breach rules when they have not breached rules in the past.

    It is quite straight forward to write a document in which each statement is complete and true. It depends what investors and regulators want. Do they want bland legal descriptions of company affairs, or descriptions which give a much more accurate account of a company's aspirations and perceived strengths? This kind of regimen will, of necessity, remove any forward looking statement from a prospectus or, if a forward statement is required, it will be so heavily qualified as to make it meaningless (viz. the future plans on a six monthly basis which appear in GEM prospectuses).

147. As a matter of record, IFAs do not take steps to satisfy themselves that the terms and conditions of a transaction are fair and reasonable, rather they seek to establish whether they are or are not fair and reasonable. We do not understand how this can or will actually work. Surely IFAs must rely on the material given to them in arriving at their conclusions and action should be taken against the providers of that information if it is false. There is no practical way for an IFA to verify this material. For example, if a company is relying on legal advice, does the sponsor have to state that it believes the

advice to be the correct interpretation of the law, when it must be obvious that the sponsor is not an expert and not competent to make this assessment? Will this necessitate a duplication of every professional role, so that the sponsor relies not on the company's advisers with whom he has no contractual arrangement but on his own where there is obviously a duty of care? Is this what is intended? Does this place an enormous cost burden on smaller applicants for listing or those engaged in any other transaction for which an IFA is required?

151. We have less difficulty with the non-expert sections in that the description of a business or its management can be drafted to be verifiable, even if it becomes less informative. The principal problem we have is with the expert sections and, in particular, the accountants' report. As is becoming apparent, the problem with many China issuers starts with the accounts. Euro-Asia Agriculture appears to provide a good example of this. If the press is to be believed, the accounts over a three year period over-stated revenues by more than twenty times. This overstatement might not have been as easy to detect as it seems because in order for it to have passed muster in an audit, the fraud must have been very elaborate and capable of yielding apparently convincing third party confirmations. In circumstances such as this, what is a sponsor to do? An apparently clean audit by a big four firm should pass an examination of scope of work, methodology and assumptions employed. This would not help.

154. Exactly what information is required by the relevant Act?

155. It would be much fairer if sponsors took responsibility for certain parts of a prospectus and accountants, lawyers and valuers, took responsibility for other parts to which they have directly contributed. We find it difficult, for example, for a sponsor to be found to have shared responsibility for a statutory audit, a title search or a mining engineer's report.

156. A sponsor should not be expected to ensure that a document is written in "plain language" when it is subject to substantial editorial amendment by the Exchange. Sometimes, language is forced on a sponsor which is anything but plain. For the reasons given above, we do not think a sponsor should give comfort on the work of experts.

157. The proposed wording is clearly designed to extend the legal and regulatory liability of the sponsor. This is a matter which is being considered by the Standing Committee on Company Law Reform and its recommendations should not be pre-empted by these proposals.

160. It will only make it a more challenging task for regulators to demonstrate successfully that there has been a failure to meet requisite standards if the proceedings of a tribunal are fair and the requisite standards are properly articulated and attainable. This is open to doubt for the reasons given above and below.

161. If the recommendations are to be followed, there will be a substantial rise in costs and major institutions may prefer to use other markets, which we believe is already a worrying trend.

164. We believe this statement is incorrect. We believe that the proposals made in the

Consultation Paper go substantially beyond requirements in the United Kingdom which follows a similar model to Hong Kong and, in practice, beyond what is required in the United States.

165. Since the costs cannot be easily quantified [see 163], this statement cannot be sensibly made.

168. We would have thought that neither the Listing Division nor the Listing Committee has the resources or procedural capabilities to do this at present. This role should be taken by SFC, since it would require little additional resource or increase in procedural capabilities. We would be supportive of a certification process.

170. For the reasons stated in our overall comments we are wholly opposed to the dual regulation of the same activity by the Exchange and SFC, respectively. It is obviously wholly unnecessary to be the subject of inspection by two authorities. It is also unacceptable to be subject to disciplinary proceedings by two regulatory authorities concerning the same matter.

171 to 172. Interestingly, the paper slips from "any professional adviser" to "sponsors or financial advisers". Irrespective of whether other professions have other disciplinary mechanisms, the rules should be used fairly to address shortcomings of all professional advisers, not a single category of them. All sponsors and financial advisers are subject to the disciplinary powers of the SFC, in addition to new powers of inspection and discipline the Exchange is now seeking for itself.

173. We disagree. It would be perfectly possible to discipline sponsors under the model code. The model code implies some level of due diligence.

176. This too is not correct. It would be perfectly possible for the SFC to take action against a sponsor which failed to perform its task properly. Failure tends not to be marginal. Issues that fail, tend to fail badly and the shortcomings are obvious. We object to regulators seeking new and wider powers when they have failed to use their existing powers properly.

177. All professional advisers should be subject to the same disciplinary sanction. It would be absurd to require otherwise.

178. It seems that while the focus of the regulation is on the individual (see 63), the sanctions are not. Both the firm and the individual are equally liable to sanctions.

180. We agree that a "demerit points" system is unsatisfactory.

182. No announcement should be made as to the reasons for the termination of a sponsorship agreement without the sponsor being able to put its side of events to the Exchange and for the explanation to be contained in any announcement.

187. We agree with a one year transitional arrangement.

188. Clearly, the proposals will be hard on sole practitioners however well qualified they may be.

194. We are strongly of the view that the Exchange should require the same standards from other professional advisers and that other professional advisers should face similar sanctions as sponsors by the Exchange. Without this, sponsors are to be singled out for special treatment and face much harsher sanctions than other professional firms. We do not see the justification for this.

195. The consultation paper should consider the role of legal advisers. The verification process and many other parts of a prospectus are largely under their control.

As a general observation the self-regulation of the profession is ineffective. We know of no incident where disciplinary proceedings have been taken against a lawyer for either listing or takeover work. If the Exchange is concerned about standards of accuracy, where in many cases the lawyers take the primary responsibility to draft and to supervise the verification of a prospectus, it cannot be wholly satisfied with the performance of the legal profession.

Lastly, it is lawyers who confirm the proper title to property not sponsors who are not competent to do so.

200. It is staggering how little the HKSA has done in the light of the major corporate failures of Enron and WorldCom. We find the conflict of interest between the corporate finance affiliates of auditing firms to be quite unmanageable and believe that no such affiliate should carry out work for a company audited by its parent. Unmanageable conflicts also arise when auditing firms are appointed to advise companies in financial difficultly at the insistence of their creditor banks.

196.-204. We wholly disagree with the exemption of accountants from the scope of the Exchange's or SFC's supervision and sanction. It is unwarranted, unreasonable and unfair.

One of the most important issues the Exchange has to address in assessing Mainland new issues is the integrity of their accounts. Accounts are usually at the heart of a misleading prospectus. It is a matter that the Exchange cannot sensibly overlook. The apparent manipulation of accounts is a very troubling aspect of Mainland issues, both from the public and private sectors. Groups which were not profitable in an unlisted state, appear in public to have been profitable. This kind of artifice tends to unravel over time as expenses and uncollected receivables which were excluded from the trading record gradually creep back into the listed issuer's accounts.

No regulatory regime can make anybody other than the reporting accountants responsible for their report. A sponsor must take unqualified and, indeed, qualified audited accounts at face value. It does not have the professional competence to do otherwise.

We would also note that the HKSA has not been effective in disciplining major accounting firms when audits of public companies have proved to have been manifestly inadequate. For example, as far as we know no disciplinary action was taken against the auditors of Guangnan Holdings, German Kitchens, Shun Shing or Allied Group, notwithstanding the apparent misstatements and audit shortcomings in their respective accounts. Further, the auditors in question went to considerable lengths to prevent their investigation by the HKSA.

If the SFC and the Exchange is trying to improve the standard and accuracy of prospectuses in Hong Kong, the integrity of the accounts should be central to its concerns and the Exchange should not avoid addressing the issue. A sponsor does not have the competence to evaluate the work of a professional reporting accountant.

205.-207. Property valuations represent an important component in many local and Mainland new issues. The pricing of an issue is often largely dependent on such a valuation. We note there appear to be no disciplinary procedures for HKIS, rather the Exchange is being presented with a "closed shop" list of suitable firms. This cannot be acceptable.

If the matter the SFC and the Exchange is trying to address is improving the standard and accuracy of prospectuses in Hong Kong, professional valuations both of fixed property and vessels should be central to its concerns and the Exchange should not avoid addressing the issue.

A sponsor does not have the competence to evaluate the work of a professional valuer.

213. There should be discouragement to the publication of valuations of businesses, brands and other intangibles in public documents. We accept that there are times when other valuations or expert reports are essential; in natural resource companies, for example. However, the traffic studies which supported the listing of toll road companies (at the insistence of the Exchange, we would add) and the valuations of technology companies (which are largely spurious) should not generally be included in a prospectus. These kinds of assessments should be made by investors themselves or securities analysts.

The proposed code of conduct for Sponsors

Overall comments

We are surprised that a code which is of interest only to regulators and the sponsors they seek to regulate has not been subject to detailed and wide ranging consultation with firms that act as sponsors and IFAs. Instead it is slipped into a consultation document as an annex and is subject to one question asking respondents "yes" or "no" on a matter to which no reference is made in the Executive Summary. This is obviously an unsatisfactory approach to have taken and differs markedly from the efforts made by the SFC to accommodate many of the concerns of practitioners before the publication of its consultation on "The Code of Conduct for Corporate Finance Advisers".

We believe that this proposed Code of Conduct for Sponsors illustrates how unworkable much of what is proposed in the Consultation Paper really is. This proposed Code cannot reasonably be followed by sponsors who simply would not (and should not be asked to try) to comply with its contents. The proposed Code is simply impractical and goes way beyond what exists in other relevant markets.

The minimum standards set out in the Code may at first reading appear reasonable. On detailed examination, they are not. They are only likely to be of relevance when things go wrong. The Code sets no particular standard with the clear intention this is to be established after the event. With the benefit of hindsight, the performance of a sponsor is bound to fall

short of the standards the Exchange will expect retrospectively, regardless of the sponsor's efforts. The sponsor is asked in effect to take responsibility for the future performance of the listed issuer's directors and the work carried out by other professional firms. It is also required to have an expert knowledge of the economy and the industry and markets a potential issuer serves, when it must be apparent the sponsor cannot be such an expert. These onerous responsibilities are being taken on by sponsors in respect of primarily PRC companies, where access to information is difficult and international standards of corporate governance and management are largely a novelty.

For large international firms this may prevent less of a problem as they can delegate to local staff the individual responsibilities of a sponsor, leaving the firm and its senior employees largely free from risk. For medium sized domestic firms, such as ours, no such segregation is possible.

Having read the Code, we understand fully why accountants and lawyers have pressed so hard to be exempt from the regulatory supervision of the Exchange. It is inconceivable that the Law Society or the HKSA would accept a code of practice drafted in these terms and administered in a manner consistent with the way the Exchange presently deals with other disciplinary matters.

Lastly, it must be self evident that the cost of sponsorship will rise significantly.

Specific comments

9. Once relations between sponsor and a listed issuer have broken down it is usually difficult for a sponsor to carry out its responsibilities effectively. In these circumstances we believe it is more sensible to encourage the existing sponsor to step aside and a new sponsor acceptable to the issuer to replace the existing sponsor.

11. The sponsor cannot "ensure" compliance. This means the sponsor underwrites compliance. Since the sponsor has no investigatory powers and must accept in many instances the information provided to it by others, it is not in a position to "ensure". This should be reworded to include "reasonable endeavours to comply with".

12(b) Is this in conflict with 9 above?

13. This goes far further than the role of sponsor. Clearly a sponsor should not deal with matters which are more sensibly be addressed by others, such as the company's auditors or lawyers. If on the other hand this paragraph simply means that the sponsor is the interface between the issuer and its other advisers on the one hand and the Exchange on the other, the paragraph should be reworded.

16. A due diligence will by definition never be "appropriate to the circumstance" if things go wrong. We note these are also minimum review procedures so that no guidance is given as to what is appropriate or what procedures are necessary to discharge a sponsor's obligation. This is specifically stated in paragraph 19. Sponsors performance is to be judged against an unspecified standard which is to be established after the fact. This is manifestly unsound and unfair.

17. This is not so. The Exchange through its vetting process makes extensive enquiries of its own which do not rely "heavily" on the sponsor and often places no reliance on the sponsor whatsoever.

19. This is written so that in disciplinary proceedings a sponsor will have no effective defence. This cannot be acceptable. When things go wrong, it is always possible with the benefit of hindsight to advance other avenues of investigation or even more thorough procedures. Sponsors do not have powers of investigation and they cannot make any intrusive investigation of third parties. This paragraph sets impossibly high standards. With hindsight, a sponsor could always be found to "reasonably have identified a problem". The Exchange should also accept that there are circumstances where one has to take documents and statements at face value. Sponsors cannot be expected to subject documents to forensic testing and in many instances government departments and regulatory authorities will not entertain enquiries from third parties. A statement in the negative often has to be accepted as it is impossible to disprove. For example, it is impossible for a sponsor to identify the true beneficial ownership of shares, if the truth is deliberately concealed.

20. The sponsor is in no position to do what is set out in this paragraph. A sponsor has no investigatory powers and cannot look behind the name of an applicant for shares. We have no idea what a sponsor is to do to check the credentials of underwriters and placement agents if they are already regulated by the SFC. The last sentence is an example of a statement which is impossible to verify independently if the parties are intent on concealing such arrangements.

21. This paragraph requires a sponsor to underwrite future performance. 21(d) would appear to be an assessment which should be made by the reporting accountants as it is in their area of competence.

22. It is unclear what a "review of [the directors'] general business acumen" means or entails, unless it is confined to (a) to (g) below. Except for state owned enterprises, in order to even contemplate a listing on the main Board and its attendant costs, the parties behind a prospective applicant have demonstrated by definition considerable business acumen. 22(a) (c) (d) and (e) are much less easily achieved than the Code suggests. (g) is not something that any sponsor we know is qualified to undertake since the matter is subjective and open to all sorts of interpretation. The SFC only provides information on disciplinary proceedings, other than Takeovers Code matters, going back to 1997 and the Exchange to 1999. It is not possible in many jurisdictions (including Hong Kong) to search for a criminal record. Credit information is difficult to obtain. In the PRC, as far as we are aware, this information is not readily available.

As with other paragraphs, the sponsor is asked to make statements of future conduct which it is in no position to give, except in heavily qualified terms.

23. We are uncertain whether regulatory authorities are given to responding to enquiries of this kind from third parties. However, we doubt it.

24. A sponsor can never satisfy itself that a material fact has not been omitted; only a person with a knowledge of the fact knows when it is omitted. Due diligence and

verification procedures are largely ineffective at exposing matters which are deliberately concealed. This is not a question of the degree of effort by the sponsor. However much effort is expended, it cannot be satisfied matters have not been kept from it. In addition, sponsors do not have the resources or powers necessary to "conduct reasonable investigations". They have to rely on what is provided to them and seek to verify it through legal enquiry and follow up. The responsibility for asking for the material should lie with the sponsor and the obligation for the material to be correct should lie with the provider.

24(a). It is unreasonable to ask a sponsor to underwrite the directors' future intentions. A sponsor is in no position to do this.

(b). We do not understand the meaning of the second sentence and, in particular, what "obtaining comfort" ..... "on agreed procedures" means. It would, however, appear to be the responsibility of the reporting accountant, not the sponsor.

(d). Bankers, in particular, but also creditors, customers and suppliers are unlikely to agree to extensive interviews. The Exchange cannot possibly expect them to agree to this. Major customers and suppliers will give some information but there are limits in practice to what can be asked of them. The Code simply ignores the practical issues of obtaining third party confirmations. A sponsor cannot make demands on a third party; rather it is asking a third party to volunteer assistance.

(f) We do not know what an analysis of the issuer's production methods would yield or what is expected of this analysis. It must be obvious that a sponsor is not a production or value engineer and cannot conduct this work. "Production" is a separate discipline requiring engineering expertise which is not normally expected of a sponsor.

(i) This review should be carried out by the issuer's lawyers.

(j) This is a very problematic area when conducting business in the Mainland. The Exchange must appreciate this.

(l) This information is seldom available in most Asian markets.

(n) A sponsor is not in a position to assess the technical feasibility of a new product or technology. It would have to rely on the expertise of others.

25. We have already expressed our concerns over this elsewhere in this letter. Sponsors are simply not qualified to cover what is set out in the paragraph. The proposal is impractical. The requirements may have some applicability with a property or vessel valuation, where outside information may be available to confirm the reasonableness of a valuation However, we take exception that sponsors are required to confirm the work of auditors, lawyers and valuers, in circumstances when the Exchange has agreed it will not expect higher standards of them, will take no disciplinary action against any of them and there is no certainty that they would be at risk of being subject to their own self-regulated disciplinary procedures; they have not in the past. This cannot be reasonable or fair.

26. It would appear that the report will become a standard request and the sponsor is likely to wish to provide it in advance of a listing approval in order greatly to mitigate any difficulties in the future. It is, of course, vital the "Review Procedures" are practical and reasonable.

29. For the reasons given above, this is impossible.

30. For the reasons given above, this is impossible.

30(a) The sponsor should be able to rely on audited figures, in the example given.

(b) We do not understand what this sub-paragraph means but it appears to be an open-ended requirement to conduct a far reaching research in a market for which there is a lacuna of reliable, current market and industry statistics.

(d) This subparagraph appears to be drafted with a business valuation in mind. We share the Exchange's skepticism of many of the business valuations which appear in public documents. However, the requirements of this sub-paragraph are not in our view appropriate for property and vessel valuations conducted by professional valuers.

Questionnaire

We do not believe that the questionnaire properly reflects the objectives set out in the Consultation Paper. Positive answers may not, therefore, be indicative of support for the proposals as they are described in the Consultation Paper.

31st July, 2003

[Cecilia/Exchange/overall comments]

CONSULTATION PAPER ON THE REGULATION OF SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

Answers to the summary of questions

Q1. We do not agree with this proposal as we do not consider that the Listing Division is equipped to consider the applications and that the proceedings by the Listing Committee have sufficient safeguards to ensure fairness.

Q2. Please see question one. The same concerns exist in respect of IFA's.

Q3. We agree.

Q4. We agree.

Q5. We agree, but would expect the Exchange to secure reciprocal recognition of Hong Kong experience by other exchanges where similar qualifications are required.

Q6. We believe that this function should be conducted by the SFC which is already involved in the registration function under the Securities and Futures Ordinance.

Q7(a). We agree but believe that subordinated shareholders' loans and parent company guarantees, where the parent has sufficient capital, should also be acceptable for meeting this requirement.

Q7(b). We agree.

Q8. We disagree for the reasons set out in detail in the attached document headed "Detailed Response to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers". We are very concerned by the assumption by the Exchange of wider investigatory powers. The SFC has these powers which do not need to be duplicated.

Q9. We agree.

Q10. We agree.

Q11. For the reasons set out in our detailed response we strongly disagree. We do not consider there is any justification for imposing additional responsibilities on sponsors for the work of other experts. Sponsors and issuers retain experts precisely for the reasons that they are expert in areas where the sponsors or issuers are not.

Q12. We strongly disagree with the Code of Conduct as drafted. For it to be acceptable it would need to be very substantially redrafted so that the standard of work required of sponsors is properly defined and set at an attainable level. Further, sponsors should not take responsibility for the action of others or be asked to give comfort on matters on which they are not qualified or competent to give a judgement.

Q13. We disagree. This question is misleading as the description in paragraph 22 of your consultation paper is inaccurate. Furthermore for the reasons set out above and in our detailed response we do not agree with this proposal.

Q14. We cannot agree with this question. The role of IFA is not to satisfy itself that the terms and conditions of a transaction are fair and reasonable; its role is to form an opinion as to whether or not the terms and conditions are fair and reasonable. For the same reasons as set out under Q.11 we do not believe IFA's should be taking on additional responsibilities for the work of experts or for the completeness and accuracy of information provide by directors.

Q15. We disagree. We believe that Sponsors and IFA should be regulated by the SFC and not both the SFC and the Exchange. The Exchange has provided no cogent reasons for proposing duplicated regulation.

Q16. We disagree for the reasons set out in Q15.

Q17. We would meet the eligibility requirements for sponsor firms or IFA firms.