Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers

A response by the Hong Kong Securities Professionals Association

July 2003

1. Introduction

1.1 We are a non-political organization with over 600 members. Our members are primarily securities practitioners in Hong Kong working in areas of securities dealing, investment management, investment research, corporate finance etc.

1.2 We welcome the opportunity to comment on the Regulation of Sponsors and IFAs. We support the objective to raise the standard of corporate finance practitioners involving the Listing Rules related transactions and Code related transactions. We do have some concerns as to the accuracy and completeness of the information provided in the Consultation. We hope that the quality of future consultation can be improved.

1.3 In many ways we find the proposals in the Consultation unreasonably harsh to sponsors and in many cases, go beyond the requirements of other major markets. Moreover we believe tougher rules may not necessarily mean better quality of market. The recently implemented SFO has provided the securities regulators with enhanced investigation and enforcement powers. It is time to put them to work and not to create more rules such as a separate licensing regime for sponsors and IFA, which could be dealt with under the SFC's New Licensing Regime.

1.4 As in many other previous proposals, in relation to corporate finance matters, the proposed rules in the Consultation give us a distinct impression that many of the rules are formulated to discriminate smaller corporate finance practitioners, which inevitably has a small net tangible asset and having small cap companies as their target clients.

1.5 We also raised a number of questions, which the Consultation has not adequately addressed and hopefully they will be addressed in the Consultation Conclusion.

2. Administration of Sponsor Regime

2.1 We do not see a sponsor/IFA, which in substance a registered/licensed corporation under Type 6 regulated activity and specialises in providing advices on IPOs and independent financial advices to independent shareholders in connection with connected transactions should be subject to

a separate licensing regime to be administer by a so called "front-line regulator". Is there any reason that the proposed criteria set out under the Consultation cannot be effectively and efficiently monitored by the SFC? Or is it another "compromised settlement" of power struggle between the HKEx and the SFC at the expense of the market and the intermediaries?

2.2 As far as the securities market is concerned, dual regulation by HKEx and the SFC is no more than a waste of resources, unclear line of responsibilities, over and duplication of regulation and power struggle exercise. The pros and cons of dual regulation of exchange participants prior to the demutualisation of the SEHK has been well understood and debated and as a result the regulatory functions of the SEHK was transferred to SFC as the sole regulator upon the demutualisation of the SEHK. We are also given to understand that due to the very fact that the dual registration system for sales representatives of exchange participants has been criticized by the brokerage community therefore HKEx is considering abolishing the registration system. So what is the point of introducing a registration system for corporate finance practitioners whom are no more than representatives of exchange participants/securities dealers specialized in the wholesale equity capital market ?

2.3 Para 57 of the Consultation attempts to explain dual licensing proposal by saying that "...The SFC's regime seeks to ensure the general fitness and properness of regulated persons, not their specific abilities and qualifications in respect of each area of business that might conduct."

2.4 Is it not one of the purposes of the SFC New Licensing Regime to cure the broadly defined regulated activities into much more narrowly defined activities (currently it has 9 types of regulated activities, including Type 6 which is specially for advising on corporate finance)? Is it not the Guidelines for Competence issued by the SFC seeks to address the issues concerning specific abilities and qualifications in respect of each area of business (including corporate finance) that licensed corporations might conduct?

2.5 Para 5.2 of the Guidelines for Competence states "Where an individual apply to carry on a Type 6 (advising on corporate finance) regulated activity and intends to give advice on matters falling with the ambit of the Codes on Takeover and Mergers and Shares Repurchases ("Codes"), he should satisfy the SFC that he has sufficient experience in this area. For this purpose, he has to complete the "Questionnaire on respondent's experience relating to the Codes". If the SFC is not satisfied that he is competent to acting on his own to advise on Codes-related matters, certain conditions may be imposed on his licence limiting the scope of his work."

2.6 So contrary to what is stated in para 57 of the Consultation, it is apparent that SFC' s New Licensing Regime does concern about licencees specific abilities and qualifications in respect of each area of business that he might conduct. Why can't we just have a separate questionnaire on listing sponsorship and IFA related matters so as to make things simpler for everyone?

2.7 Para 59 of the Consultation states "... there will be inevitably be a degree of overlap between the SFC's regime.... Suitable arrangements are being put in place".

2.8 What are such arrangements? Why can't the Consultation deal with it in one go? Is there any hidden agenda that the authorities do not want to consult the public?

2.9 The uncertainty of whether the listing functions will remain with the HKEx or will eventually be transferred to SFC is also a key factor to be considered before concluding the rules and regulations of the sponsors regime. What is the point of having the proposed regime administered by the HKEx when it is no longer approving listing applications?

3. Separate lists for Sponsors and IFAs

3.1 We are disappointed that he Consultation did not set out the arguments for maintaining a separate lists for sponsors and IFAs nor did it draw the readers attention that all other major securities markets have not adopted a similar licensing regime separately for IFAs and that if the proposed IFA licensing regime is adopted such system will be unique the world over.

3.2 Para 81 of the Consultation states " We propose that the ***same factors*** be taken into account in determining the ***accountability*** of IFAs as are taken into account for sponsors, save for the minimum capital requirement...". The Consultation goes further to suggest that "... range, scale and complexity of services they [*IFAs*] will provide by contrast to sponsors firms [*are lesser*]".

3.3 Such statement is absolutely untrue, misleading and grossly undermined the workload and duties of IFAs. Even though the duties for sponsors and IFAs may be different in nature, transactions currently require an IFA under the Listing Rules, Takeovers Code and Repurchase Code are equally complex and demanding as any IPO, if not more.

3.4 What about financial advisers advising listed issuers on corporate finance matters, do they require to be registered yet on a separate list?

3.5 We are of the opinion there is no justifiable reasons to maintain a separate listing of sponsors and IFAs.

4. Admission criteria for Sponsors and IFAs

4.1 Under the SFC's New Licensing Regime which took effect since 1st April, 2003, all persons providing corporate finance advise, including sponsors and IFAs are required to obtain license under Type 6 regulated activities from the SFC. Beside the definition provided under para 1.2 of Corporate Finance

Adviser Code of Conduct, such advises also can be broadly categorized into to two types namely Listing Rules related transactions and Takeovers/Repurchases Codes related transactions. It is widely understood by corporate finance practitioners that despite obtaining Type 6 licensing, it will not automatically qualifies such corporation to undertake Codes related transactions. And it is not unusual that licenses are granted with conditions e.g. those firm has no experienced personnel in the Codes will be bar from taking on such transactions on its own.(see above)

4.2 We cannot see why it cannot be done for Listing Rules related transactions. Such transactions including IPOs and connected transactions should be subject to admission criteria (including number of responsible officers and capital requirements) under the same licensing regime save for relevant experiences of responsible officers. The proposed admission criteria and regime do nothing more but to confuse the public as to licensing criteria for persons providing corporate finance advice and it is absolutely ridiculous if one has obtained license to carried out Type 6 regulated activities without any attached conditions to find out that he is not eligible to be a sponsor or an IFA.

4.3 We are also disappointed that the Consultation did not set out the arguments for having a minimum capital of HK$10 million nor did it draw the readers' attention that no such requirements existed in the UK and no attempt has been made to justify why such a requirement is necessary for Hong Kong but merely mentioned that it is the existing requirement for GEM sponsors to which market practitioners objected previously in the relevant consultation (but no consultation conclusion was ever published).

4.4 We proposed that all admission criteria should be the same as those required under Type 6 regulated activities. However, the two responsible officers should be able to meet the experience set out in para 75 of the Consultation. Those do not meet such criteria should be issued with a conditional license that such person will not be allow to act on its own. This also solves the problem of having a co-sponsor category and this is exactly how it is done for Codes related transactions.

5. Undertakings to the Exchange

5.1 Para 97 of the Consultation proposes that Eligible Supervisors to provide the Exchange with a written undertaking in similar terms to that provided by sponsor firms and IFA firms. The Consultation attempts to justify its proposal by saying sponsor firm and IFA firm depends on the standards of Eligible Supervisors and they can freely move between firms so that should be personally liable.

5.2 We find such arguments unconvincing. Professional services firms involved in a listing application including lawyers, accountants, valuers all depend on the standard of conduct of their qualified personnel to ensure their duties and obligations are properly discharged and such personnel can also freely move

between firms. Why no such requirements are proposed for them? What about other major markets? No such requirements exist in UK, as well as other major markets. Are the standards of work of sponsors in UK depends on other means other than their qualified personnel? Are there any laws prohibiting their personnel moving freely between firms?

6. List of unacceptable individuals

6.1 Para 54 of the Consultation states "...the Exchange will maintain a list of unacceptable individuals.... Any individual...may do sponsor or IFA work...provided that he or she is not on the list of unacceptable persons."

6.2 The Consultation however give no detail as to how such a list is complied or whether there is a mechanism for fair hearing and appeal process. Nor does it provides any explanation as to whether there is any inadequacy in SFC's New Licensing Regime which took effect on April 2003 and how is it possible for an unacceptable individual baring from doing sponsor or IFA can still satisfy the Fit and Proper Criteria and the Guidance of Competence requirements of the SFC and hold a valid licence.

6.3 The proposed "list of unacceptable person" is yet another evidence that things are done by the Regulators in a "Black Box" fashion. We would like to express our strongest objection to this proposal.

7. Independence

7.1 One of the specific circumstances in determining the independence of the sponsor is stated in para 119 of Consultation which says "...the fair value of the shareholding referred to above [5%] exceeding 15% of the consolidated net tangible assets of sponsor group..."

7.2 It is not uncommon for sponsors to receive shares of a listing candidate in lieu of cash as its remuneration for its services. The proposal will bar sponsors with lower net tangible assets from receiving a value of fees which should be determined solely on the merits of its service rendered and should not be determined by the size of its net tangible assets but a commercial decision between the contracted parties.

7.3 Para 120 of the Consultation states that "We do not propose to stipulate any threshold on banking relationship between a sponsor and a new listing applicant..."

7.4 If one can propose a threshold on net tangible assets for a sponsor group, on shareholding in listing applicant why it cannot be done on its bankers? If a listing applicant's principal banker is also a part of the sponsor group, is it not there is an obvious question on independence? Or is it just another proposal intended to favour banks?

7.5 As in many other previous proposals in relation to corporate finance matters, the proposed rules in the Consultation give us a distinct impression that many of the rules are formulated to discriminate smaller corporate finance practitioners which inevitably has a small net tangible asset and having small cap companies as their target clients.

7.6 As far as references to international standard the Consultation only mentioned UK requirements but not the world's largest capital market- US's requirements. It is interesting to note that in 1999, the IPO of Goldman Sachs Group Inc was sole lead managed by Goldman Sachs & Co, is it implying that US has a poorer standard or is US not an international market worth comparing?

8. Responsibilities of Sponsors

8.1 It has been well established that the responsibility of prospectus rests solely on the directors of the issuers and persons acting as experts in the prospectus are only responsible to the information they authorized to be disclosed in the prospectus.

8.2 The Consultation seems to suggest that sponsors have or at least it is the expectation of the Exchange that sponsors should have the same responsibilities and thereby proposing in para 156 of the Consultation to require sponsors to make certain statement in the listing documents so that sponsors would be held to "authorizing" its issue.

8.3 Is it fair and equitable that advisers should assume the same responsibilities as their principals? Is it fair to expect advisers have the same intimate knowledge of the business as the directors of the listing candidates? We certainly do not agree.

8.4 Para 132 states that "The UK Listing Rules impose requirements similar to those of GEM. Moreover, the UK long form reporting practice by reporting accountants, which sponsors require to perform, broadly covers the same steps as those proposed in the Chapter 3A Consultation Paper with respect to financial information." And para 133 implies that this is the international standard for sponsors.

8.5 But if one turn to page 83 of Annex 1, in fact UK do not require sponsors to sign the prospectus under the UK Rules nor sponsors are expected to take overall responsibility for the listing documents, they merely responsible for those parts of prospectus in which they provide expert opinion (just like the current practice in Hong Kong.)

8.6 In addition, sponsors are not to be seen as the equivalent role of auditors in financial statements. The role of auditors is to report to the shareholders by expressing an independent opinion to the true and fairness on financial statements prepared by the management. Both Main Board and GEM Listing require a sponsor to satisfy itself, on the basis of available

information, that a new listing applicant is suitable for listing and to be closely involved in the preparation of the listing document and ensure that all material statements therein have been verified.

8.7 By nature, sponsors are advisers of the issuers and accountable to the issuer and is performing a different role to that of an auditor. How effective could one expect a person closely involved in the preparation of the listing document to audit his own work?

8.8 Should a prospectus contain any material inaccurate and misleading statements, the most equitable and effective way to sanction issuers and advisers including sponsors is for the regulators to rigorously enforce the laws (with all the powers now provided under the SFO) against the principal i.e. the issuers. As a defense, issuers would naturally counter claim their advisers for negligent and wrongful advices. This way the fear of punitive damages by sponsors and other professional advisers will become as real as in the US.

8.9 It seems illogical and unfair that regulators should go after the advisers directly under civil actions, let alone criminal actions.

8.10 Para 133 of the Consultation further states that " ... In the view of the Exchange, the reluctance of intermediaries to accept additional requirements can no longer be considered an adequate reason to defer the introduction of full international standards."

8.11 We are shocked by such an irresponsible statement. Market practitioners in Hong Kong are more than happy to accept additional responsibilities if such responsibilities are fair and equitable. If one talks about responsibilities and obligations, one must also say something about rights. In practice, regulators in may ways dictate what would be disclosed and which statements would be taken out of the listing documents. If the Consultation proposes that sponsors and its personnel should take full responsibilities of the content listing document, then the issuers and their advisers should have the final say on the content of the very document that they are suppose to take full responsibilities!

8.12 Para 24 of the Consultation states that "... During the vetting process, the Listing Division has often made detailed comments [i.e. dictating what would be disclosed and which statements would be taken out] covering both principal matters and drafting issues ...of the prospectus. This approach may have inadvertently led to the perception by some sponsors that it is the Listing Division, rather than the listing applicants and their sponsors, who are responsible for ensuring the standard and quality of the prospectus..."

8.13 Given the existing vetting process, no wonder why listing applicants and their sponsors have such a wrong but realistic perception about who are responsible for ensuring the standard and quality of the prospectus.

9. International Standards

9.1 The term "International standards" has been used frequently in the Consultation however the term is not clearly defined in the Consultation. If one read carefully from the information provided in Annex 1, it is apparently that there is lack of a consistency standards among the 4 markets quoted in the Consultation in relation to most of the proposals set out therein. A few, but not majority, of the proposals has made references to the UK regime only. What about other major markets? Do these markets have adopted similar regulations? If not, why not? What about the Japanese market and the German market? Why nothing has been mentioned about these markets which are consistently ranked amongst the top five markets in the world?

9.2 We are of the view that one cannot claim a particular rule or regulation is the international standard, if they have not been adopted by all or majority of the world's top 5 capital markets.

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

see paras 2.1-2.9 of our response

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.

see paras 3.1-3.4 of our response

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.

see paras 6.1-6.3 of our response

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.

see paras 3.1-3.4 of our response

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.

see paras 3.1-3.4 of our response

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.

see para 2.1 of our response

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.

see para 4.3 of our response

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

☐ *Yes*

☒ *No*

Please state reason(s) for your view.

see para 4.3 of our response

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.

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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 form 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.

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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 that 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.

see paras 7.1-7.6 of our response

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.

see paras 8.1-8.13 of our response

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.

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.

see paras 8.1-8.13 of our response

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.

see paras 8.1-8.13 of our response

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 it's 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.

see para 2.1 of our response

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.

see paras 6.1-6.3 of our response

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* N/A

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

☐ *Yes*

☐ *No* N/A

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

☐ *Yes*

☐ *No* N/A

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

☐ *Yes*

☐ *No* N/A

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?

N/A