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31 July 2003

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

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

Dear Sirs,

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

I refer to the Consultation paper on The Regulation of Sponsors and Independent Finance Advisers issued by the Exchange and the SFC jointly in May 2003 (the "Consultation Paper"). I enclose my comments in the Appendix, incorporating an executive summary and a set of detailed comments, for your due consideration. Unless otherwise defined, terms used herein have the same meanings as in the Consultation Paper.

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

I believe that the introduction of a more comprehensive regulatory framework by expanding and strengthening the existing framework would increase the accountability of market practitioners and provide a more healthy environment. I do no believe that this aim can be achieved by shifting all responsibility to the financial advisers as appears in the proposal.

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Furthermore, we appreciate that overseas regulatory regime offers certain successful examples which is a good reference point. Nevertheless, in considering new regulations, due regard should be given to the fact that Hong Kong is a unique market which serves as a platform for corporation established and/or operated in the People's Republic China ("PRC"). The unique political, social and legal infrastructure of the PRC produced a number of issues which cannot be found any other jurisdictions worldwide. Such issues often proves to be difficult and cannot be resolved with traditional solutions. We believe that any new proposals have to be able to allow market practitioners to meet the challenges posed by the unique features of the Hong Kong market while at the same time increase the accountability of market practitioners. I consider that rules of overseas markets should only be a reference and should be tailored to cater for practical issues in implementation, instead of importing in full in Hong Kong.

I would like to draw your attention to the following specific comments:

- **Proposals stemming from the Exchange to regulate independent financial advisers and/or sponsors**

  I disagree with the various proposals regarding regulation of corporate finance advisers. Independent financial advisers are persons licensed by the SFC and already regulated by the Corporate Finance Adviser Code of Conduct and other Codes of the SFC. These proposals include those (i) imposing new licensing requirements for IFA and acceptable individuals, (ii) introducing a code of conduct for IFA, (iii) creating disciplinary proceedings against IFA and (iv) imposing that only sponsors can advise on various fund raising activities as opposed to IPO currently.

  These proposals if implemented represent a duplication of regulatory functions of the SFC and will be at the expense of the shareholders of the Exchange, unless the SFC is to carve out their powers and responsibilities over these market practitioners in the future. Furthermore, regulation of market practitioners, which has been the role of the SFC under the existing Hong Kong regulatory regime, is not the principal objectives for the establishment of the Exchange, which is to operate a fair securities market.

- **Proposals to impose qualification on sponsors**

  I disagree with the various proposals that tighten the eligibility of registered persons being sponsors (e.g. minimum capital requirements, having three completed significant transactions of which at least one IPO, removal of co-sponsor system, etc.).

  I disagree that a corporate finance adviser who has not completed any IPO over a four year period can no longer act as sponsor. Among others, sponsor's role includes giving financial advice (e.g. assessing business models of and building financial model for an applicant, assessing risks of an applicant and suitability of going public) as well as provision of totally distinct regulatory and procedural compliance advice (e.g. compliance with Chapter 9 of the Listing Rules). The Exchange may view that such corporate finance adviser (the adviser who has not sponsored any completed IPO for four years) may not be familiar with the procedural requirements of the Exchange, and therefore should not qualify to act as sponsor of an IPO. I disagree with this proposition because

  (a) Whether or not a corporate finance adviser has completed any IPO over a four year period, he continues to possess the necessary skills to provide financial advice, which is more essential and critical in ensuring quality of an applicant or an issuer, for which an adviser is willing act and to associate his name;

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(b) The provision of procedural compliance advice can easily be assisted by and/or delegated to legal advisers to the underwriters, which is currently the case in respect of listing sizeable companies (the legal advisers prepare the underlying documents for signature by the sponsor for submission to the Exchange). I can't see why this approach is not acceptable across the board if sizeable and international sponsor firms are already adopting it. The sponsor firm continues to bear responsibility on all submissions and the consequence of not complying with the laid-down procedures for IPO. It must be emphasized that familiar with procedural rules will not of itself ensure qualitative companies be selected for listing nor improve the profile of the Hong Kong stock market;

(c) If there is any unwritten rule or practice which is so essential that omission of which would render an applicant not suitable for listing (therefore only companies with current sponsorship experience can act as sponsor), it is the responsibility of the Exchange to disseminate such rules or practice to the market through a proper channel (e.g. press announcement or formal rule changes, etc.), instead of through private communication with an individual firm in dealing with a particular case; and

(d) Acting as co-sponsor having joint responsibility with the sponsor, lead sponsor or other joint sponsors will alleviate the concerns of the Exchange in this respect.

In respect of licensing for sponsors, I suggest the Exchange to adopt the currently licensing regime of the SFC in respect of sole advisers for Takeovers Code matters, in the sense that (i) only one responsible officer is required to be licensed in order for the firm to act as a sole sponsor; (ii) the responsible officer is qualified after he has played a key role in the sponsorship of a completed IPO while working in a lead sponsor or a co-sponsor firm and shall not be required to complete an IPO in every four years; (iii) unqualified individuals or firms can sponsor a listing applicant provided they do not act on a sole basis (i.e. be allowed to act as co-sponsor). In respect of licensing for IFAs, I suggest the Exchange admits all qualified corporate finance advisers licensed by the SFC under the Securities and Futures Ordinance.

The proposal penalizes local advisers who set a high standard in accepting clients. It also precludes firms and individuals from undertaking sponsorship work again once they failed to attain the qualification, unless the firm recruits four new senior responsible officers (for the firm) and the registered individuals work for another qualified sponsor (provided that the newly joined sponsor firm is able to sponsor one completed IPO in every four years) as a junior staff (for the individual). The proposal appears to stem from a wrong perception that the success of an IPO is the sole responsibility of the sponsor, and neglect the fact that it is the joint efforts and responsibility of a team of professionals and the management of an issuer instead.

Furthermore, corporate finance advisory businesses are not capital intensive in nature and sponsors do not necessarily underwrite IPO. The imposition of a minimum capital requirement on sponsors only favour registered persons registered under Types 1 and/or 8 of the Securities and Futures Ordinance who already have to comply with the minimum capital requirements imposed by the SFC, but do not raise the standard of the market.

- **Proposals for Sponsors' and IFAs' declaration**

I disagree with the various proposals that require sponsors and IFAs to provide confirmation in a direct (confirmation in non-expert section) or indirect (confirmation in

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expert section) manner. It is impracticable to perform any form of due diligence in respect of certain matters (such as forecast information, opinions, etc.) or other information.

Furthermore, I would also like to comment on the design of Annex 3 to the Consultation Paper. It requests the respondent to give a positive or negative answer only to a summary set of questions set out therein, which basically do not cover all proposals. Each question raised a number of issues, some of which are acceptable, while others are unacceptable. However, a simple positive or negative answer can hardly give justice to the complicated issues raised in the proposals, which have far fetching implications on the conduct of corporate finance advisers in the Hong Kong market.

Finally, I note that the Stock Exchange did not set out the proposed rules in detail as contrast to what the SFC has been doing in respect of each proposed change to the Takeovers Code and what the Stock Exchange had done in 2001 regarding the proposed changes in the Listing Rules. Due to lack of transparency and details, I find that it is extremely difficult to give full comments purely on just a "blue paper", instead of a full "white paper". In this respect, I would like to reserve an opportunity to give more detailed comments when the proposed rule is available in details.

Should you like to have any meeting with me to discuss my comments, please do not hesitate to contact me at the above address or by telephone ((852) 3121 9813).

Yours faithfully

Lillian Mak
Director

Encl.

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

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

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

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

In view of the proposed requirement that sponsors should complete at least one IPO each year to be continuing eligible, it would appear that the protracted administrative process of the Exchange on its own would render the proposal not practical, without taking into account the market conditions which will affect the

chances of completing a corporate finance transactions and are beyond the control of the corporate finance advisers.

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

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.

Maintaining a list of acceptable IFAs by the Stock Exchange is a duplication of work of the SFC. We agree that the Exchange can disallow persons not on the list of registered persons of the SFC from acting as IFAs in a connected transaction. Please note our concerns on (i) the admission criteria (Questions 4 to 8), (ii) on-going eligibility (Question 5), and (iii) the formation of the new list.

Can those financial institutions which would like to be sponsors as well as IFAs make a single application for both qualifications? Although not all financial institutions are interested in the smaller IFA market, they may apply for such qualifications so that they have the flexibility of providing a wide range of activities for marketing purposes and to shelter from market downturn of any one aspect of corporate finance activities. As such, in addition to the applications launched by those financial institutions which have a focus on IFA market or are not currently qualified as sponsors, the number of applications could be significant and it is important that suitable transitional arrangement be provided for to ensure that market practitioners can meet the requirements of the new rules within the stipulated timeframe. In this regard, we would like to query whether or not the Exchange has

conducted a survey to access the volume of work it may be facing once the proposal is implemented and whether or not the Exchange has sufficient personnel to perform the duties on a timely and efficient manner?

It should also be noted that the skill set for the discharge of the role of an IFA may be different from that of a sponsor and may be narrower than that of an FA. The role of the IFA is to analyze and opine on the fairness and reasonableness of the terms of the transaction in question (from the independent shareholders' point of view) whilst sponsors and FAs, in addition to advising on the terms of the transactions, will have to advise clients on compliance matters.

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.

We agree with (a). We agree with (b) but not for the criteria to become eligible persons.

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

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

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

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

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

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.

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

We note that the UKLA requires the sponsor to have at least four eligible employees who (i) are being employed at an appropriate level of seniority within the sponsor, and (ii) have provided advice in connection with a significant transaction at least three times in the preceding 36 months and at least once in the preceding 12 months. It does not necessarily mean that the sponsor must have four "senior" supervisors or an IFA must have two "senior" supervisors. The fact that GEM board requires two Principal Supervisors and two Assistant Supervisors merely reflect that more manpower resources are required in handling GEM applicants, which are perceived to carry higher level of risks and in discharging the ongoing sponsorship requirements. As main board applicants are not perceived to carry as much risk as GEM applicants, the requirements of having two principal supervisors and two assistant supervisors should not also apply.

In addition, under the current regime on Codes on Takeovers and Mergers and Share Repurchases (the "Takeovers Code"), a firm with only one registered person licensed to advise on takeover code matters can undertake work governed by the Takeovers Code. Matters governed by the Takeovers Code are as complicated as other corporate finance transactions and IPO, we do not see the rationale for the proposed requirements of two eligible supervisors to carry out IFA work. By far, it

is understood that the SFC has been managing this licensing regime for takeovers matters satisfactorily and no abnormal instances known to the public have occurred. As such, we think that the current licensing regime of the SFC applicable for advisers advising on takeover matters of having one qualified persons suffices. Eventually, the qualified individual bears responsibility of the quality of his advice and the consequence of remaining suitable to be licensed.

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.

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

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

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

Our objections to the proposal are as follows:

(a) The Exchange may claim that a finance adviser, who has not sponsored any completed IPO for four years, may not be kept up to date with the procedural requirements of the Exchange. It must be appreciated that a sponsor's role, among others, includes giving financial advice (e.g. assessing business models of and building financial model for an applicant, assessing risks of an applicant and suitability of going public) as well as provision of totally distinct regulatory and procedural compliance advice (e.g. compliance with Chapter 9 of the Listing Rules). The fact that such financial adviser may not be familiar with the latest practice of the Exchange in handling IPO should not be a reason for precluding them from acting as sponsor, because

i. Whether or not he has completed any IPO over a four year period, a corporate finance adviser continues to possess the necessary skills to provide financial advice, which is more essential and critical in ensuring the quality of an applicant or an issuer, for which an adviser is willing act and to associate his name;

ii. The provision of procedural compliance advice can easily be assisted by and/or delegated to legal advisers to the underwriters, which is often the case currently in respect of the listing of sizeable companies (the legal advisers prepare the underlying documents for signature by the sponsor for submission to the Exchange). We can't see why this approach is not acceptable across the board if sizeable and international sponsor firms are already adopting it. The sponsor firm eventually has and continues to bear responsibility for all submissions and the consequence of not complying with the laid-down procedures or practices. It must be emphasized that familiar with procedural rules will not of itself ensure qualitative companies are selected for listing nor improve the profile of the Hong Kong stock market;

iii. If there is any unwritten rule or practice which is so essential that omission of which would render an applicant not suitable for listing (therefore only companies with current sponsorship experience can act as sponsor), it is the responsibility of the Exchange to disseminate such rules or practice to the market through a proper channel (e.g. press announcement or formal rule changes, etc.). A proper dissemination of rule or practice will also avoid different teams within the corporate finance unit of the Exchange and different market practitioners adopting different approach; and

iv. Acting as co-sponsor having joint responsibilities with the sponsor or other joint sponsors will alleviate the concerns of the Exchange in this respect.

We believe an assistant supervisor (as defined in the GEM rules) with three years' corporate finance experience should be able to handle an IPO properly under the supervision of a principal supervisor with perhaps over 10 years' corporate finance experience. However, under the proposal, such principal supervisor would not qualify as an eligible supervisor.

It is noted that the takeover transactions are no less complex as an IPO. Accordingly, we consider the Exchange should adopt the current licensing regime of the SFC for sole advisers on Takeovers Code matters – a registered person will become licensed to give sole advise on transactions governed by the Takeovers Code if he is able to demonstrate his ability in one completed transaction involving the issue of a shareholders' circular governed by the Takeovers Code. Such license will not automatically be withdrawn purely by the fact that they have failed to complete one takeover over a period of four years. By adopting such approach, a licensed person having demonstrated that he has sponsored (whether on a sole, joint or co sponsor) one completed IPO would be qualified to act as sponsor or thereafter. If a firm or an individual is not qualified to act as 'sole' sponsor, the registered person can continue to sponsor listing applicant, provided that he does not act on a sole basis (entitled to act as a co-sponsor). We suggest that the currently system of allowing co-sponsor continues to apply.

(b) An eligible supervisor is required to have at least four years of relevant corporate finance advisory experience derived in respect of companies listed on recognized stock exchanges or from other channels, such as experience gained from

employment with listed companies listed on the Stock Exchange. Although it is not very clear from the proposal, it appears that experience gained by auditors and lawyers in advising listed companies on corporate finance matters will not be taken into account. It is our view that the platform for recognized corporate finance advisory experience is too narrowly set. In particular, legal advisers also play a key role in advising applicants and issuers in complying with listing rules, whether or not on application procedural matters, disclosure and do/don't, especially in sizeable IPO. Under the policy statement of the TSX, an officer is not required to have "at least five continuous years of relevant experience with an underwriter" if that person can satisfy any one of the other requirements, e.g., a licensed CFA or CBV. In the premises, we suggest that if a person can demonstrate that he/she has acquired the relevant experience from an avenue other than listed companies or sponsor firms, such experience should also be recognized.

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

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

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

(f) The definition of "significant transactions" is too narrow. The proposed definition set out in paragraph 76 does not included top-up placing / placing, debt restructuring, rescue proposal, redomicile, listing by way of introduction, spin-off, capital reorganization, discloseable transaction, privatization,

whitewasher application, etc. No reasons have been given why some of the transactions are recognized as "significant transactions" but not others. In particular, it is accepted in UKLA that a related party transaction involving the preparation of a circular is qualified (and so does the GEM Board under current practice).

(g) It should also be noted that a discloseable transaction or a transaction not even notifiable under Chapter 14 of the Listing Rules for a sizeable blue-chip company may involve billions of dollars. Most often, the adviser, who advises on such transaction, is required to perform no less due diligence work as for other major transactions or VSA for small listed companies. The fact that such transactions are not announced or announced and set out in a circular that calls for less extensive disclosure (e.g. no accountants' report, valuation report, indebtedness statement, etc.) does not mean that the adviser to such transaction lacks the requisite skills and knowledge of the listing rules. It is because these advisers are also required to, among others, review the valuation, analyse the financial statements of the target companies, consider the impact of the transaction on the listed issuer. We do not share that the knowledge of combining such information in a shareholders' circular as required by the Listing Rules is so essential for a registered person to be able to act as a sponsor or an IFA. It should also be noted it is not uncommon that shareholders' circulars are prepared, submitted to the Exchange by legal advisers who seek clearance from the Exchange.

(h) We consider that listing of investment companies should not be excluded. Sponsors, who are required to possess the skill set to assess the performance of funds managed by investment companies directors and advising on listing rules compliance, requires no less expertise than sponsors in other IPO.

(i) In paragraph 75 of the Consultation Paper, a "substantive role" means "*a role as a member of the sponsor firm's core transaction team in delivering or managing the delivery of one or more of the major components of due diligence work undertaken in respect of an engagement*". The definition contains a number of ambiguous concepts which are subject to discretion of the Exchange and may prove to be difficult. Such concepts include the meaning of "core transaction team", "managing the delivery", "major components of due diligence work". Depending on the complicity of the engagement, different personnel may be involved in different phases of an engagement. Moreover, the definition appears to cover due diligence work only, what about the transaction team that perform valuation of the target companies, advise on the terms of the agreements and execute the same? It is our view that instead of the requiring the delivering or managing the delivery of the due diligence work of an engagement, the requirement should be "providing advice" as presently adopted in the UKLA and by the GEM Board.

(j) We strongly disagree with the proposed IFA licensing regime. We consider the existing SFC licensing requirements suffice. We are not aware of any similar requirement in other developed markets.

(k) Under the proposal, only firms on the sponsor list can provide advice on transactions like rights issue, open offer, other transaction that require the production of a listing document, etc. We strongly disagree with this proposal because we do not agree that corporate finance advisers who have not completed IPO in the last four years no longer possess the skills set to advice on these fund raising transactions, etc. Furthermore, we perceive that the responsibility for the compilation of a listing document can easily be discharged by an experienced corporate finance adviser or a legal adviser.

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

The proposal penalizes local advisers who set a high standard in accepting clients. The proposal also precludes firms and individuals from undertaking sponsorship work again once they failed to attain the qualification, unless the firm recruits four new senior responsible officers and the registered individuals work for another qualified sponsor (in the expectation that the sponsor is able to sponsor one completed IPO in every four years) as a junior staff. The proposal appears to stem from a wrong perception that the success of an IPO is the sole responsibility of the sponsor, and neglect the fact that instead it is the joint efforts and responsibility of a team of professionals and the management of an issuer.

It is not healthy for the market if market practitioners push to complete transactions not simply for the interest of an issuer, but in order for themselves to remain on the list of sponsors or IFAs. It is of course difficult to prove the ultimate intention of a corporate finance adviser of pushing a deal, but the market will eventually suffer in the long-run under such circumstance, and the Exchange cannot be excused for creating a system to encourage corporate finance adviser to promote its self interests at the expense of the market.

Other factors relevant to the eligibility criteria
(Paragraphs 80 to 81 and 86 to 94 of Part B of the Consultation Paper)

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

- The eligibility criteria requirements, including minimum capital, number of eligible supervisors, experience of individual eligible supervisors, are not met;

- The applicant is unable to satisfy the Exchange that it will be able to discharge the obligations in paragraph 7 of the proposed Code of Conduct for Sponsors and Independent Financial Advisers (these obligations include having effective supervisory, monitoring and reporting controls, an effective compliance function, adequate competence, professional expertise and human and technical resources and maintaining proper books and records);

- Current suspension or revocation of regulatory status (including where this is self-imposed as a result of settlement); and

- Suspension or revocation of regulatory status (including where this is self-imposed as a result of settlement) that has expired but in relation to which, the applicant is unable to satisfy the Exchange that appropriate and sufficient remedial steps have been taken.

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

Q.6 Do you agree with our proposal?

☐ *Yes*

☑ *No*

Please state reason(s) for your view.

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

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.

We do not agree with the proposal that a sponsor firm should have a minimum capital requirement of HK$10 million.

The fact that a GEM sponsor is required to maintain a minimum capital should not apply to main board sponsorship system because main board applicants are not perceived to carry the high level of risk as for GEM applicants as the Exchange regard

at the time of introduction of the GEM board.

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

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

☑ *Yes*

☐ *No*

Please state reason(s) for your view.

We concur that there should not be minimum capital requirements for IFA firms, because provision of corporate finance advisory services is not capital intensive.

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

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

includes an obligation that the eligible supervisors and directors of sponsor firms and IFA firms use their best endeavours to ensure the sponsor firm or IFA firm complies with its obligations under the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. A breach of the undertaking will be deemed to be a breach of the Listing Rules and will be subject to disciplinary action.

Q.8 Do you agree with our proposals?

☐ *Yes*

☑ *No*

Please state reason(s) for your view.

We do not agree with the proposal.

Under the proposal, both sponsor firm/IFA firms and individual eligible supervisors have to provide the Exchange with an undertaking. Each corporate finance advisers are already bound to comply with the Code of Conduct for Corporate Finance Advisers issued by the SFC in December 2001 and various other codes and guidelines.

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

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

Extending the role of the Exchange to regulate market practitioners is not only against the objectives of the establishment of the Exchange, but will also waste resources of a listed company (the Exchange) at the expense of its shareholders on performing work outside its core objectives and work already being performed by the securities market regulator. We do not see why duplicating the efforts of another regulator can assist the Exchange to promote the profile of the Exchange.

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.

We do not agree with the proposal.

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

We consider the Exchange to adopt the current SFC licensing regime for sole adviser on Takeovers Code matters, in the sense that any adviser who is not qualified to act as a sole sponsor can sponsor an applicant for listing as a co-sponsor. All sponsors, whether co-sponsor, lead sponsor or joint sponsor should bear full responsibility for the conduct of an IPO.

It is not clear whether the "primary sponsor" is to bear more responsibility if any statement in the public document turns out to be incorrect or misleading. If the "primary sponsor" is the point of communication with the Exchange, it will be sufficient to designate them as the point of conduct instead of "primary". Does it suggest other sponsor takes a secondary role to the "primary sponsor" and bear lower level of responsibility? We wonder how such system can promote the quality of the Hong Kong stock market if a sponsor to a sizeable transaction can take a secondary role.

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

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

(b) In spite of the potential substantial increase in operating cost to listed companies,

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

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

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

decision-making". No reason was given in the Consultation Paper as to why the Exchange felt that this difficulty as annunciated in paragraph 113 is not applicable to the proposal to retain the discretion in paragraph 110 of the Consultation Paper.

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

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

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

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

We also strongly disagree that an IFA must be a firm either on the list of acceptable sponsors or list of acceptable IFAs (see reply to question 2 above).

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.

Although we agree that in some stances as set out in the Consultation Paper do affect the independence of a sponsor firm / IFA firm, we do not think all the circumstances set out therein affect the ability of the sponsor to give "impartial advice" and to discharge its duties independently.

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

We are of the view that different rules shall apply in determining the independence of a sponsor for IPO and of an IFA for a connected transaction, and we generally agree to codify the independence standard for an IFA.

In addition, we note that the independence of an IFA relating to the Code-related matters is stricter than that relating to the Exchange matters. However, due to the nature of the Exchange matters, we think that a firm can qualify to be an IFA (other than any shareholding interest) if it has not served as a financial adviser to the issuer and its subsidiaries or the connected persons of the contemplated transaction within the past 12 months.

We suggest that the current practices that co-sponsors and joint sponsors be allowed in certain circumstances in order to alleviate the concern on independence of sponsors.

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.

We do not agree that there is an expectation gap between the Exchange's view of the responsibilities of sponsors and the manner in which many sponsors are

discharging those responsibilities simply because of the recent corporate scandals.

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

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

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

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

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

CODE OF CONDUCT FOR SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

(Annex 2)

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

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

☐ *Yes*

☑ *No*

Please state reason(s) for your view.

We agree with some of the matters set out the Code of Conduct for Sponsors and Independent Financial Adviser (the "Code of Conduct"), but not all. It is proposed that a registered person under the SFO has to observe the requirements of the Listing Rules including the Code of Conduct. Such provisions would render a person subject to the regulation of both the Exchange and SFC which is not necessary. This is because a person who has breached the Code of Conduct may not be regarded as fit and proper and as such would not probably be able to remain as a registered person. We do not see the reason of having a single breach of regulation subject to duplicate proceedings of two regulatory authorities. In this regard, we are of the view that the Exchange should coordinate with the SFC to enable the SFC to take appropriate action under the SFO. We are of the view that the Code of Conduct should be a code of practice to help the firms improve their corporate governance and operations (Question 6).

We consider that the proposed requirements set out in the Code of Conduct should be strictly applicable only to sponsor firm(s) and IFA firm(s) (but not their eligible supervisors, other directors and/or staff) given that it is the firm rather than the individual to accept and perform the work for an issuer.

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

(Paragraphs 153 to 165 of Part B of the Consultation Paper)

We propose that both sponsors and lead underwriters (where the latter are different from the former) should make a statement in listing documents regarding the extent of their due diligence which would track the form of statement currently given to the Exchange on a private basis by sponsors subject to the modification noted below. A sponsor is also expected to ensure that the document presents a fair impression of the issuer and that it has been written in plain language. The sponsor's due diligence obligation is modified in respect of reports and information published in a listing document with the consent of an expert. The form of declaration proposed recognises this distinction. In respect of "non-expert sections" of a listing document we propose that the following statement should be made "[Sponsor firm and underwriter] confirm(s), at the date of this document, that after reasonable investigation it believes/they believe and have reasonable grounds to believe that the information set

out in this listing document at [make specific references] is not materially false or misleading" and, in respect of "expert sections", an alternative test of due diligence that "it/they have no grounds to believe and do not believe that the information set out in those sections of the listing document at [make specific references], which have been prepared and authorised by [name], is materially false or misleading".

Q.13 Do you agree with our proposals?

☐ *Yes*

☑ *No*

Please state reason(s) for your view.

We do not agree with the proposal and it is our view that the proposal is made without giving any regard to the market practice in Hong Kong and the role of a lead underwriter in a Hong Kong IPO. No reason is given for the proposal nor has the proposal deal with the different role of a sponsor and a lead underwriter. Whatever due diligence the lead underwriter has undertaken, such due diligence work are undertaken for the purpose of deciding whether or not to underwrite the offer, not for the purpose of making public statements to the investing public.

On the other hand, a sponsor in sponsoring the listing application has given various confirmation to the Exchange and under current practice, also regarded as an "expert" under the Companies Ordinance.

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

As mentioned in Q11, we note that the Exchange proposes to request the sponsors for conducting reasonable investigations on several areas of concern, namely (i) suitability of listing, (ii) "non-expert sections", and (iii) "expert sections" which allow the Exchange to rely upon during its assessment of the applicant's listing application and listing document. While, according to the proposed requirement herein, the Stock Exchange would like the sponsor to make a declaration regarding its reasonable investigations on "non-expert sections" and "expert sections" in the prospectus subsequent to its vetting process. We wonder whether it is necessary to do so. Nevertheless, as discussed earlier, notwithstanding that we can make investigations (or any applicable review procedures), it is impracticable for us to fully

satisfy itself and/or to assure the Exchange whether all the information set out in the "non-expert sections" is without any omission or not misleading. Given the aforesaid limitation, we consider that the sponsor (or the lead underwriter) is not able to provide such declaration. It may be more appropriate to advise the investors to be fully aware of the particular nature of the information set out in the "non-expert sections".

In respect of certain matters (like independence of public investors or experts), the sponsor simply lack statutory power to extend full scope of due diligence to obtain further comfort (e.g. they cannot summon investors to court for investigation of independence, cannot obtain cash flow statements from banks directly to confirm the sources of funds of investors in an IPO). In such cases, what additional steps can a sponsor take apart from relying on confirmations from directors of an issuer. Sponsors are not expecting such statutory powers as exercise of such power will not promote the Hong Kong stock market. Do you think investors would find the Hong Kong stock market attractive if they find themselves subject to be summoned to investigation in court or find a third party having a right to look into their personal bank accounts whenever they subscribe for shares in Hong Kong?

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.

We do not agree with the proposal.

It is proposed that the Exchange would also like the IFA to perform due diligence work in assessing the correctness and completeness of all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement and to make a declaration thereon in its letter as enclosed in the circular subsequent to its vetting process. Again, notwithstanding that an IFA, can make appropriate steps and due diligence work, as in the case of sponsors, it is impracticable for the IFA to assure the Exchange that all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement is without any omission or not misleading. (Please refer to question 12 and 13 above). In addition, if an IFA is to give an opinion on the expert section as suggested in the proposal, the IFA would have to engage another expert to comment on the work of the issuer's engaged expert. We doubt whether an additional expert can bring any added value, but certainly will bring additional cost burden for the issuer. Given the aforesaid limitation, we consider that an IFA is not able to provide such declaration.

Q15. Reporting obligations and monitoring

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.

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

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

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.16Do you agree with our proposals?

☐ *Yes*

√☐ *No*

Please state reason(s) for your view.

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

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

Furthermore, registered persons are already subject to supervision by the SFC, who is empowered to instigate any investigation and impose any disciplinary sanctions against any registered person if circumstances necessitate. As stated before, it is not the objectives for the establishment of the Exchange to regulate corporate finance advisers or other market practitioners and it will be against of the interests of the shareholders of the Exchange to do something against its objectives, especially something which duplicates the work already under the jurisdiction of its regulator (the securities market regulator, the SFC).

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*

- I fulfill the requirement of being an eligible supervisor for IFA, but do not fulfill the requirements of being an eligible supervisor for sponsor, of not having sponsored a completed IPO in the last 2 years.

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

☐ *Yes*

☑ *No*

- We do not perceive that additional cases can be completed for IPO in six months' time in view of the current market condition.

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

☐ *Yes*

☑ *No*

- It is not realistic to try and provide an answer for (c) – as it is difficult to predict the performance of the market in the forthcoming year, it is difficult to perceive if additional cases can be completed in the forthcoming 18 months.

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

☐ *Yes*

☑ *No*

- It is not realistic to try and provide an answer for (d) – as it is difficult to predict the performance of the market in the forthcoming 2 years, it is difficult to perceive if additional cases can be completed in 2 years' time.

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?

The Exchange has stated in paragraph 187 of the Consultation Paper that "those firms who currently have less than 3 persons who satisfy the eligible supervisor requirement could use the initial one-year transitional period to identify 3 eligible supervisors and use the additional year to identify a fourth". This may be easier said than done as cost may exceed the benefits.

We refer to our concern set out in Q5 that it is uncertain as to whether each of our 4 "eligible" supervisors can complete at least one "significant transaction" in the then recent year to fulfill the proposed requirement. Nevertheless, we would like to reiterate our response to Q4 that the requirement as stipulated by the UKLA does not necessarily mean that the sponsor must have four "senior" supervisors.

Instead of allowing longer transitional periods, the Exchange should reconsider the revising its proposed eligibility criteria for sponsor according to our suggestion of adopting the current SFC licensing regime for sole advisers on advising on Takeovers Codes, in the sense that each firm requires one responsible officer to have substantial experience in one completed IPO before and no requirements to complete IPO every four years;

In respect of IFA, we suggest advisers properly licensed under the current SFC licensing regime qualifies to act as IFAs.

Appendix

Response to Consultation paper on
The Regulation of Sponsors and Independent Financial Advisers (May 2003)

Executive Summary

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

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

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

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

(d) We do not agree with the new proposal of "eligible supervisors". The reasons for our objection to this concept are further elaborate in our response to question five in Annex 3 attached. We are of the view that the existing two SFC licensing requirements for corporate finance advisers suffices for licensing of IFAs and the concept of SFC licensing requirement for sole adviser on Takeovers matters should be applied for licensing sponsors, as further elaborated in Annex 3. Furthermore, the proposal is insufficient to provide for other non-eligible supervisors, to become eligible supervisors.

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

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

(g) We do not agree with the proposal on minimum capital requirement for sponsor firms because corporate finance advisory work is not by its nature capital intensive. We do not see the correlation between the work quality

and the amount of capital as suggested by the Exchange in the Consultation Paper.

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

(i) We do not agree with the proposal of mandatory appointment of a sponsor firms as on-going sponsor for all listed issuer on the Main Board and the GEM. This is because for a majority of the listed companies this is not necessary given that level of corporate activities of most of the listed companies. We believe that the UK system of requiring the appointment of sponsors in a wide spectrum of corporate finance activities is more beneficial to the market and provide better protection to minority shareholders.

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

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

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

It is our view that instead of introducing a new system to regulate the discharge of responsibilities of sponsors and IFAs, steps should be taken in the direction of some of the proposals set out in the Consultation Paper within the existing regulatory regime. We believe that the existing regime of having all corporate finance advisers

regulated by the licensing system of the SFC under the Securities and Futures Ordinance is working well and there is no need to introduce a two tier regulation system. Instead, we believe that the Exchange, as the front line regulator with close contacts with corporate finance advisers should strengthen its cooperation with the SFC so that the SFC can regulate and monitor the activities of the intermediaries subject to its regulatory regime more efficient so as increase the accountability of market practitioners.

We do not agree that the Exchange should retain an overall discretionary power in a number of aspects. This is because it is always difficult for discretionary power to be exercised in a consistent manner and discretionary power should be exercised on occasions to cater for unforesseable circumstances rather than as part of a set of rules.