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31st July, 2003

BY EMAIL & FAX

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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"). This letter set out my comments on the various proposal contained in the Consultation Paper.

Unless otherwise defined, terms used herein shall have the same meanings as in the Consultation Paper.

My response to the proposals in the Consultation Paper are set out in two parts in this letter. Part A sets out my general comments thereto and Part B sets out my specific comments to the proposals in the order of the summary of questions set out in Annex 3 to the Consultation Paper.

PART A - GENERAL COMMENTS

Instead of responding to the questions posed in Annex 3 to the Consultation Paper, I have chosen to respond to the proposal in the Consultation Paper by way of a letter as it is my view that the design of Annex 3 is inadequate to deal with the issues raised by the proposal as the answers to each of the questions may not be a definitive yes or no. I am of the view that by simply giving either a yes or no to the questions hardly do 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.

It is proposed in the Consultation Paper that a common regime, administered by the Exchange be established regarding the acceptability of corporate financial advisers who wish to act as sponsors or IFA to prospective applicants or listed issuers on either the Main Board or GEM and to provide further guidance to clarify the responsibilities of sponsors and IFA.

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

- (a) In principal, I agree with the need to have a common regime for both the Main Board and the GEM by maintaining a list of acceptable sponsor firms and IFA firms.
- (b) I agree that in considering the admission 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. The proposed approach may actually work towards reducing the risk of sponsors acting as co-sponsors in "name" only as indicated in paragraph 64 of the Consultation Paper.
- (c) I do not agree with the concept of maintaining a list of "unacceptable individuals". Instead, I am of the view that a list of "acceptable individuals" should be maintained. Stating a positive list would put the Exchange in better light and also give potential issuers more certainty when selecting sponsors or IFAs.
- (d) I do not agree with the new proposal of "eligible supervisors". The reasons for my objection to this concept are further elaborated in my response to question five below. I am of the view that the existing two tiers system of principal supervisor and assistant supervisor as used in GEM should be maintained.
- (e) I believe the 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 subjected to further consultation and discussion with market practitioners to ascertain the practicability of such proposals.
- (f) I do not agree with the proposal that each sponsor firm should have four eligible supervisors and each IFA firm should have two eligible. I believe that this proposal is not practical and proposed without reference to the current market conditions.
- (g) I 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. I do not see the correlation between the work quality and the amount of capital as suggested by the Exchange in the Consultation

Paper. However, if the Exchange's need for a minimum capital requirement is to ensure that the sponsor firms have the required capital to cover potential liabilities resulting from legal actions, then the need would make more sense. If this is the case, I believe the Exchange should consider implementing a compulsory insurance scheme rather than imposing a minimum capital requirement.

- (h) I do not agree with the proposal that sponsor firms and IFA firms should provide the undertaking to the Exchange. I agree that the code of conduct of sponsors should be revised and further elaborated 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 that I believe should be subjected to further consultation and discussion
- (i) I 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 as Main Board issuers are normally by comparison more established than their GEM counterparts. In addition, as the majority of the Main Board listed companies does not have a sufficient level of corporate activities to justify the additional costs, I 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.
- (j) I agree in principal that sponsor firm 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, I do agree with the instance set out in the Consultation Paper as instances in which a sponsor firm is regarded as not impartial. I believe that the role of a sponsor should be distinguished from that of the IFA in this regard. I believe that the Consultation Paper has also failed to take into account of the possibilities of a change in control of the issuer or, change in personnel at the sponsor or IFA firms during the period specified that may result in the conflict being removed, but deemed continuing under the proposal as set out in the Consultation Paper.
- (k) I 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 current role of the lead underwriter in an IPO in Hong Kong. The lead underwriter typically only gets involved in an IPO at a late-stage and therefore would not have had prior opportunities to carry out due diligence. Requiring them to give the same undertaking as the sponsor would necessarily mean that the market process would have to be changed dramatically, which I do not believe is necessary.
- (l) I agree that the administration and monitoring of sponsors and IFAs on the relevant list should be streamlined. However, I do not agree with the proposal that the Exchange should retain discretion beyond the certification of sponsors and IFAs.

It is my view that instead of introducing a new system to regulate the discharge

of responsibilities of sponsors and IFAs, I am of the view that steps should be taken in the direction of some of the proposals set out in the Consultation Paper within the existing regulatory regime. I believe that the existing regime of having all corporate finance advisers regulated by the licensing system of the SFC under the SFO is working ill and there is no need to introduce a two-tier regulation. Instead, I 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.

In addition, I 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 unforeseeable circumstances rather than as part of a set of rules. Uncertainty in the situations where discretionary powers may be used does not assist the Exchange in keeping an orderly market.

PART B – SPECIFIC COMMENTS

Q1. Acceptable sponsor firms

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

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

- whether a sponsor who is admitted to the list of sponsors for GEM will be automatically admitted to the list of sponsor for Main Board and vice versa; or sponsors have to make separate application for admission to the list of sponsor for Main Board and GEM, respectively; and
- if separate application has to be made for admission to the list of sponsors of GEM and Main Board separately, will it be a procedural matter or will the application be independently vetted by the GEM Listing Division and Main Board Listing Division.

I am of the view that the above are very important issues which must be clarified for market practitioners to form an informed view on the proposals. In particular, the current experience with GEM demonstrates that the application process is a time consuming and tedious process with the same issue being queried by separate officers over a long period of time.

In addition, I have strong concerns on (i) the admission criteria {see Q4-8}, (ii) on-going eligibility {see Q5}, (iii) independence {see Q10}, and (iv) the transition process.

Q2. Acceptable IFA firms

I believe that a list of acceptable IFAs can be maintained by the Stock Exchange. However, I also have strong concerns on (i) the admission criteria {see Q4-8}, (ii) on-going eligibility {see Q5}, 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 qualification so that they are flexible enough to provide a wide range of activities for marketing purpose. As such, in addition to the applications launched by those financial institutions which have a focus on the IFA market or are not currently qualified as sponsors, the number of applications can be significant which takes longer processing time.

Q3. Acceptable individuals

I do not agree with the proposal of maintaining a list of unacceptable individuals. I am of the view that a list of acceptable individuals should be maintained by the Stock Exchange instead.

No reasons was set out in the Consultation Paper as to why the Stock Exchange considers it is more appropriate to main a list of unacceptable individuals contrary to maintaining a list of acceptable individuals. Nor are the criteria as to how the Stock 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 implication on the livelihood of an individual whose name is being put on the list of unacceptable individual, which is made public on the website of the Stock Exchange, I consider the proposal to be highly objectionable. Not only will the livelihood of the individual be 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.

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, if not impossible 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 cannot achieve the same goal. I would assume that providing an acceptable list would provide more certainty to the market and put the Hong Kong equity market in a more positive light. As the saying goes, a half full glass is better than a half empty glass.

Furthermore, all personnel engaging in the provision of corporate finance advisory work have to be licensed/registered under the SFO. In applying to be licensed/registered under the SFO, an individual has to be a "fit and proper person". It is difficult to imagine how an individual who pass the "fit and proper person" test of the SFC and yet be regarded as an unacceptable individual by the Stock Exchange.

Q4. Competence and experience of the sponsor and IFA firms

I agree that focus should be put on the experience of the individual member of staff, rather than the sponsor firm or IFA firm to avoid creating entry barrier to new firms staffed by experience personnel. However, I have strong concerns 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.

I 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. As such, I think that the GEM Board setting of having two Principal Supervisors and two Assistant Supervisors is good enough.

Q5. Qualification and experience criteria of eligible supervisors

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.

My objections to the proposal are as follows:

- (a) Compared with overseas jurisdictions, the proposed requirement of four years experience with at least one transactions completed within the previous two years are also too long and 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, including the complexity of the transaction and market sentiment. It is not unusual for complicated transactions to take over a year to complete. ✓
- (b) Under the proposal, experience derived from recognized overseas markets will be recognized and only one significant transaction in Hong Kong market is required. While I 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. ✓
- (c) The definition of "significant transactions" is too narrow. The proposed definition set out in paragraph 76 does not include top-up placing / placing, debt restructuring, rescue proposal, re-domicile, capital reorganization, major and ✓

discloseable transaction, whitewasher application. 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 qualifies as a "significant transaction" (and so does the GEM Board under current practice).

- (d) 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 the discretion of the Stock Exchange and may prove to be difficult to determine with certainty. 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 involve in different phases of the engagement. Moreover, the definition appears to cover due diligence work only, and does not cover aspects of work carried out by other team members that does not include due diligence work. It is my view that instead of 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. It is possible that the Exchange may set a non-exhaustive list of "advice" which it may consider acceptable as "substantive role".

My 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 support the number of transactions. Based on historical figures as set out in the Exchange's website, quite a number of sponsor firms will fail the requirement.

Q6. Other factors relevant to the eligibility criteria

I consider that there should be 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, for the four criteria listed out in paragraph 80 of the Consultation Paper, it is unclear as to under what 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 remedial steps regarding suspension or revocation of regulatory status.

Q7. Minimum capital requirement of sponsor firms

I do not agree with the proposal that sponsor firm should have a minimum capital requirement of HK\$10 million. On the other hand, I concur that there should not be minimum capital requirements for IFA firms.

For a practically 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 of required for corporate advisory work or the relationship between the capital amount and the work of the sponsor.

However, if the Exchange's need for a minimum capital requirement is to ensure that the sponsor firms have the required capital to cover potential liabilities resulting from legal actions, then the need would make more sense. If this is the case, I believe the Exchange should consider implementing a compulsory insurance scheme rather than imposing a minimum capital requirement.

Q8. Undertakings to the Exchange

I do not agree with the proposal.

Under the proposal, both sponsor firm/IFA firm and individual eligible supervisors have to provide the Exchange with an undertaking. Under Section 23 of the Securities and Futures Ordinance (Chapter 571 of the Law of Hong Kong), the Stock Exchange is to provide a fair, orderly and efficient market for the trading of securities. As such, I doubt whether "the sponsor (and also its eligible supervisors) to make the proposed undertakings to the Stock 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, I are uncertain as to whether the listing rules which are designated for governing 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. I 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.

Q9. Appointment

I 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 sponsor will be designated as the "primary sponsor". It is not clear under this proposal as to the meaning of "large IPO" and the

party responsible for determining whether an IPO is a "large IPO". An IPO with a large offering size does not necessarily mean it is complicated as to warrant more manpower which may require the cooperation of additional sponsors. Furthermore, it is not spelled out in the Consultation Paper as to who will determine whether more than one sponsor firm is required for an IPO. I am of the view that the issue as to whether more than one sponsor firm is required should be left to the market practitioner for final determination.

It is also proposed to make it compulsory for both Main Board and GEM listed companies to appoint a sponsor firm as financial adviser for a certain period of time after listing. For reasons set out below, I disagree with the proposal of mandatory appointment for Main Board listed companies:

- (a) Main Board issuers are normally by comparison more established than their GEM counterparts. In addition, as the majority of the Main Board listed companies does not have a sufficient level of corporate activities to justify the additional costs, I 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.
- (b) The Exchange appears to be of the view that the appointment of on-going sponsor will improve the disclosure of listed companies. Whilst I agree that the appointment of on-going sponsor can assist in the corporate governance of the issuer, this may not always be the case as 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.
- (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". 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 caused by factors beyond his control. I believe that the Exchange needs to rethink the circumstances where waiver is granted.

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 detailed criteria were set out in the Consultation Paper as to the circumstances under which the Stock Exchange will exercise its discretion. 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 opposite of 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 announced in paragraph 113 is not applicable to the proposal to retain the discretion in paragraph 110 of the Consultation Paper.

I am of the view that the appointment of on-going sponsors for the Main Board for listed companies should be subject to further consultation with listed issuers, applicants, potential applicants and investor public. It is not just a matter between the Exchange and the sponsors and the Exchange should not completely rule out the cost factor.

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."

I believe that an approach similar to that in the UKLA should be adopted. I 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).

Q10. Independence

Although I agree that in some stances, set out therein do affect the independence of the sponsor firm /IFA firm, I 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. Furthermore, I am of the view that a distinction should be drawn between sponsor for IPO and IFA in this regard.

According to the "Sponsor's confirmation of independence" as required by the UKLA, I 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, I do not consider that the existence of such interests or relationship must prelude a

firm from acting as a sponsor.

In addition, I note that the independence of an IFA relating to Code-related matters is stricter than that relating to the Stock Exchange matters. However, due to the nature of the Stock Exchange matters, I think that a firm can qualify to be an IFA (other than any shareholding interest) if it does not serve as a financial adviser to the issuer and its subsidiaries within the past 12 months. I believe that the Consultation Paper has also failed to take into account of the possibilities of a change in control of the issuer or, change in personnel at the sponsor or IFA firms during the period specified that may result in the conflict being removed, but deemed continuing under the proposal as set out in the Consultation Paper.

Q11. Responsibilities

I 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.

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. In fact, this is what sponsors in Hong Kong 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 stipulate 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 in 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 information available in public records. However, there is no full proof way to cross-check all data with public data. Furthermore, it is not unusual for companies not to keep everything in writing. For example, transactions may occur 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 whatsoever with them. There is in practice no way for a sponsor to cross check this information apart from making enquiry with the directors and that third party and accepted was being told on face value. I 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. Given the role as a sponsor, I believe that it is not unreasonable that sponsors should be required to take certain review procedures regarding the suitability of listing of the issuers.

On the other hand, 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 to make the same misleading is unreasonable. 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 reasonable avenue to ascertain the truth and completeness of the information. In most instances, sponsors would expressly warn readers of the practical difficulty although it is the practice of the Exchange to request the deletion of such warning statements in total disregard of the practical difficulty facing sponsors and the consequence of not having such a warning statement. Whilst the sponsors will no doubt continue to carry out their duties in accordance with market expectations, such a statement is required to inform the public of the possibilities of incomplete information beyond the control of sponsors. If the potential investors choose to carry on with the investment, the sponsor should not be held liable unless it is a result of the reckless disregard on the part of the sponsors. 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 it reasonable can 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", I believe that it is sufficient for the Exchange to rely upon their statements. Considering the approach of the TSX on the use of experts which I 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.

In the event that the Exchange insist on such a requirement, the only conceivable avenue is for the sponsor to engage another "expert", at the issuer's costs, with the necessary skill set to give the sponsor their independent view on the independent view provided by the independent "experts" of the issuer. The current requirement that a sponsor's lawyer be appointed is an example of such a situation. In my opinion, I believe there is no need for appointing "experts" to review work done by other "experts" as there will be duplication of actions and the cost may be prohibitively high.

Q12. Code of Conduct for Sponsors and Independent Financial Advisers

I agree with some of the matters set out the Code of Conduct for Sponsors and Independent Financial Adviser (the "Code of Conduct"). It is proposed in the Code of Conduct that it will be a requirement of the Corporate Finance Adviser Code of Conduct issued by the SFC that a registered person under the SFO has to observe the requirements of the Listing Rules including the Code of Conduct. Given that breach of the Code of Conduct would cast prima facie doubt on the fitness and properness of that person with respect to their registration under the SFO. As such, I do not see the reason for the Exchange to insist that a breach of the requirements of the Code of Conduct constitutes a breach of the Listing Rules. 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 his registration under the SFO would probably not be renewed. I do not see the reason of having a single breach of regulation subject to proceedings of two regulatory authorities. In this regards, I am of the view that the Stock Exchange should coordinate with the SFC to enable the SFC to take appropriate action under the SFO. I am also of the view that the Code of Conduct should be a code of practice to help the firms improve their corporate governance and operations {see Q6}.

I consider that the proposed requirements set out in the Code of Conduct should be strictly be 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 who accepts the work for an issuer. In addition, I have concerns whether it is practicable for (i) a sponsor or (ii) an IFA to fully satisfy itself and/or to assure the Stock Exchange whether (i) all the information set out in the "non-expert sections" in relation to an IPO, or (ii) all the information (including expert advice or opinion relied on) in relation to a transaction or an arrangement respectively, is without any omission or not misleading.

Q13. Declaration by sponsors and lead underwriters in listing documents to be registered

I do not agree with the proposal and it is my 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 dealt 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. The lead underwriter typically only gets involved in an IPO at a late-stage and therefore would not have had prior opportunities to carry out due diligence. Requiring them to give the same undertaking as the sponsor would necessarily mean that the market process would have to be changed dramatically, which I do not believe is necessary. 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, I have considered the approach taken by the UKLA, the TSX and the ASX in this regard. I noticed that there is no similar 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 me that the expert itself is responsible for its statement or opinion expressed in the prospectus.

As mentioned in Q11, I note that the Exchange proposes to request the sponsors to conduct 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. I wonder whether it is necessary to do so. Nevertheless, as discussed earlier, notwithstanding that a sponsor can make investigations (or any applicable review procedures), it is impracticable for the sponsor 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, I 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".

Q14. IFA due diligence declaration

I 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 take appropriate steps and conduct due diligence work, it is impracticable for an IFA to fully satisfy itself and/or to assure the Stock Exchange whether 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. Given the aforesaid limitation, I consider that the IFA is

not able to provide such declaration.

Q15. Reporting obligations and monitoring

I 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, I 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.

I 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 will be abuse to such an extent that the residual monitoring tools would become the main crust of the monitoring rules without according the same the status of formal rules. This is highly undesirable as this would not only add to administrative burden but also create confusion for corporate finance advisers. Furthermore, I am of the view that a number of monitoring tools suggested are not of sufficiently objective for an objective unbiased 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. .

Q16. Compliance and sanctions

I am 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. I 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.

I am 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. I 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 undertake the engagement to perform the sponsor's work for an issuer. In addition, it is also the firm that gets the economic benefits of such an engagement. It is irrelevant that individuals get paid by the company as an employee, as they would have been paid in any event for as long as they are employed by the company irrespective of whether the firm gets the work. I am of the view that the introduction of the list of sponsor firms / IFA 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 I 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.

Q17/18. Ability of existing GEM and Main Board sponsors and IFAs to meet eligibility criteria for acceptable lists

(a) Yes, if effective today.

- (b) Yes, if effective in 6 months time.
- (c) Not certain, if effective in 18 months time.
- (d) Not certain, if effective in 30 months time.

I 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, I 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. In fact, I think that the GEM Board setting of having two Principal Supervisors and two Assistant Supervisors is good enough and so far, prove to serve the purpose.

If you should have any questions on my answers and would like further clarifications, please do not hesitate to email your questions to

[Redacted]

Thank you.

Yours sincerely,

[Redacted Signature]

Lai Voon Wai
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 Principal Supervisor under GEM