Shenyin Wanguo Group

Shenyin Wanguo Capital (H.K.) Limited

STRICTLY PRIVATE AND CONFIDENTIAL

31 July, 2003

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Securities and Futures Commission
Corporate Finance Division
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Dear Sirs,

Consultation Paper on
the Regulation of Sponsors and Independent Financial Advisers

We thought it would be helpful to state our position and the major areas of concern in relation to the proposed amendments to the Listing Rules put forward in the consultation paper at the outset. We also enclose with this letter our detailed response to the Summary of Questions appearing as Annex 3 to the paper for your consideration.

1. We are supportive of the concept of having a general qualifying system for participants in the corporate finance market as a whole to ensure that transactions are handled by established firms staffed with experienced personnel to the benefit of all users, notably issuers and investors alike. We would also welcome the introduction of a set of suggested due diligence review procedures as guidelines to assist sponsors and IFAs when determining the scope of due diligence review required for any particular transaction to ensure that good quality of disclosure is maintained. However, some of the proposed procedures are, in our opinion, impractical as they are defying market reality and would not be acceptable to the commercial community at large. Such procedures, if taken on board in their present form, would result in the promulgation of standards and procedures that might only become hollow statements.

2. We believe participants in the market do not object to the assumption of responsibilities and, for that matter, liabilities arising from it that are rightly attributed

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to them. It is common ground that major corporate finance transactions involve teamwork where there are clear delineations of responsibilities among the various professional parties in relation to their respective areas of expertise. To attach ultimate and overall responsibility to sponsors for work undertaken by other parties in respect of their areas of expertise will be grossly unfair and is simply ignoring the reality about how professional parties see and play their roles among themselves during the course of a transaction. This regulatory stance appears to have arisen out of the premise that sponsors have superior access to information about issuers and have a better understanding of the business of the issuer. However, we are of the view that such premise is a misconception since there are direct contractual relationships between the issuer and each and every professional party which would enable them to gain access to client's information on an individual basis and any suggestion that a professional party, other than the sponsor, has an understanding of its client's business which is not as good as the sponsor is an insult to its professionalism. Frankly, we would doubt if any one can discharge his professional duties and responsibilities properly if he does not have an in-depth and comprehensive understanding of his client's business.

It has been proposed that sponsors should review the expert opinion or statements by looking into the bases and assumptions made. As experts, they would have sound justifications for the bases and assumptions. Given their understanding of the issuer's business and of the business environment in which it operates is as good as that of the sponsor, we believe that they are far more equipped than sponsors to come up with bases and assumptions which are reliable, having regard to the amount of resources which frequent players in the field, such as the international accounting firms with global practice, have vis a vis a medium size sponsor.

So far the well publicized corporate scandals have, in the main, involved commercial crimes and accounting frauds. To that extent, would it not be more appropriate and fair that the reporting accountants should be held partly or equally responsible with the management and major shareholder, rather than the sponsor, for any wrong committed or mis-information or misrepresentation. In the ultimate analysis, the quality of disclosure depends on the information provided by and the integrity of the management of the issuer. It must therefore be recognized that the directors of the issuer have the primary obligation to ensure the accuracy and completeness of information given to all relevant parties, including the regulators. The sponsor (or its employees or agents) does not and should not have the power to be involved in the day to day operations or any major corporate decisions of the issuer which rightly belong to the directors.

3. The case for attaching clear responsibilities to sponsor stems from the premise that the extension of prospectus related liability in the Companies Ordinance to IPO sponsors is a forgone conclusion. The Stock Exchange appears to be quite open about its intention to "achieve substantially the same result" by having "such an explicit statement". However, it is extremely dangerous and detrimental to the market for the Stock Exchange to run ahead of the legislation, if passed at all, with such serious consequences for participants. We believe if there is sufficient consensus about the need for such legislation and the public views it as a matter of great urgency, there would be enough social pressure to accelerate the legislative process. As it stands, we do not see such urgency articulated nor do we have the

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benefit of hearing deliberations setting arguments for and against the case in full. Therefore, to extend such liability by requiring a declaration in the prospectus by the sponsor and lead manager about due diligence work they have performed and mandating eligible supervisors to give a personal undertaking on compliance is a totally ill-conceived idea and we are opposed to these proposals at a time when there is no clear consensus on this issue among the market participants and, in a broader context, the public community at large. Moreover, it is our view that a breach of such undertaking may create an exposure for the individual concerned to criminal prosecution which may not otherwise exist under current statutes because we see that the introduction of such requirements is likely to shift the evidential burden to the defendant by creating a prima facie case against that individual.

We wish to state that most overseas stock markets do not impose such requirements and a movement towards such requirements is out of line with international practice and is wholly unacceptable, unwarranted and unjustifiable for sponsors and individuals working for them.

At this juncture, we would like to make some suggestions on how to improve the quality of disclosure, especially on financial statements.

A. to impose a similar qualifying and disciplinary system (with clear guidelines regarding standards and responsibilities expected of them and sanctions for breach of duty) for all other professional parties who wish to participate in the corporate finance market so that standards for their areas of expertise can be upheld and improved.

B. to ensure high standards of accounting work for IPO transactions, it is advisable that we separate the role of auditors and reporting accountants by mandating the engagement of two separate, independent firms of accountants to avoid any conflicts or perceived conflicts of interest.

C. to introduce long form reporting as a standard procedure in IPO transactions so that a more in-depth study can be made about the issuer's business and operations.

D. to strengthen enforcement of the existing rules and regulations would be a much better approach, in bringing pressure to bear on sponsors to perform properly and in deterring management who are unfit to run public companies, than to lay down yet more new rules itself.

E. to deploy more resources in the education of issuers (their management) and investors as we believe all participants, including the regulators, are responsible for any market scandals and to ask sponsors to bear the brunt of the criticism from investors is grossly unfair.

Finally, we should view the poor quality of disclosure in a wider social context. After all, it should be appreciated that a lot of the recently listed companies came from Mainland China with its own peculiar political and economic system, a not well-developed legal system and an environment which is hard to gain access to reliable source of information. These are genuine risk factors associated with an emerging market that one should bear in mind when investing in such companies and the market should and has dealt with such

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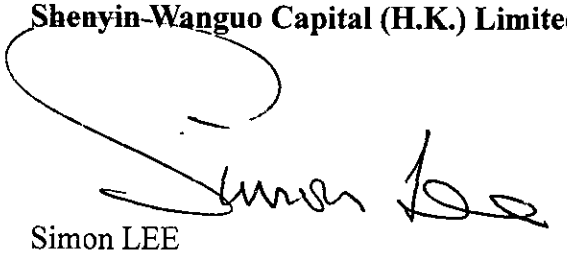
risks by an appropriate pricing of an offering. The lack of a well developed legal system and a very different market with its own practices render due diligence of a standard applicable to a matured market impossible. By taking a disclosure based approach about an issuer itself without taking into account such systemic risks would bound to result in disappointment and the regulators should be prepared to strike a fine balance between investors' expectation and what professional parties could reasonably deliver.

Yours faithfully,
For and on behalf of
Shenyin-Wanguo Capital (H.K.) Limited



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Consultation Paper

On

The Regulation of Sponsors and Independent Financial Advisers

Reply to Questions Stated in Annex 3 – Summary of Questions

1	Yes. However, the Stock Exchange shall inform the applicants in writing if their applications are disapproved by the Stock Exchange stating the reasons for the Stock Exchange's decisions and publish the results of applications made and the reasons on a regular basis to improve the transparency of the decision-making process.
2	Yes.
3	Yes
4	Yes
5	No. It benefits the investment market as a whole if all professional parties involved in corporate finance transactions can uphold high professional standards. The Stock Exchange and the SFC (the "Regulators") should understand that intermediaries like sponsors, auditors, lawyers and valuers have different areas of expertise and it is unreasonable and ineffective to enhance the quality of public documents by uplifting the admission requirements, responsibilities and penalties for sponsors alone. Moreover, the definition of "substantive role" is narrowly defined in the consultation paper and appears to be very much due diligence oriented. The roles played by a sponsor are wider and expected to include mainly the pre-mandate assessment, due diligence (a substantial part of which is to be carried out after signing the mandate), advising the prospective issuer on matters relating to the Listing Rules and corporate restructuring for the purpose of listing, drafting/review of the prospectus and other listing documents, coordinating and reviewing the work performed by other professional parties and answering the queries from the Stock Exchange and SFC etc. Therefore, a capable supervisor should possess a number of skill sets including market knowledge, regulatory knowledge, business acumen, client relationship management and due diligence. Therefore, it is more appropriate to define the

	"substantive role" of eligible supervisors broader to mean having "substantive involvement in one or more of the following activities : (a) advising the prospective IPO issuer on fulfilling the requirements under the Listing Rules; (b) performing due diligence on the prospective issuer together with other professional advisers; (c) preparation and review of prospectus and other listing documents; and (d) communicating with the Regulators to address the issues raised by them in relation to the listing application."
6	Yes, subject to the clarification from the Stock Exchange on the criteria for its assessment and the publication of decisions on refusal or cancellation with detailed reasoning.
7a	No. There has been no or, at most, very few reported cases in which the sponsor, who was also an underwriter, failed to fulfill its obligations in taking up the unsubscribed shares. Underwriters have their own risk control policies to manage their underwriting risks, typically through sub-underwriting. There is no scientific basis for the proposed benchmark of capital requirement for all sponsor firms. In practice, there are sponsor firms who do not participate in underwriting and focus only on advisory work. It is therefore unnecessary for such sponsor firms to tie up such a large amount of funds on capital.
7b	Yes.
8	No. It is sufficient for the sponsor firm to provide such undertaking. To require eligible supervisors to provide a personal undertaking is over-regulating and is out of line with international practice. Such requirement is superfluous in that (i) the Regulators can always penalize the eligible supervisors if they are found to have not performed to their professional standards and not discharged their responsibilities to the satisfaction of the Regulators on a fair and reasonable basis; and (ii) given that the corporate finance community is relatively small in Hong Kong, any under-performed eligible supervisors who are found to have damaged the reputation of their employers will be extremely difficult to find a job with other firms.
9	Yes.

	However, the role and responsibilities of post-listing sponsors should be amended as follows : 1. The sponsor is to advise the issuer on matters relating to the Listing Rules and Takeovers Code and to assist the issuer in complying with the relevant disclosure requirements in relation to any announcements or public documents. However, the issuers should be responsible for the statements made in, and publication of, announcements and public documents. Afterall, it is the authorized persons of the issuers, such as a director or the company secretary, who prepare and authorize the issuance of the public documents. 2. The sponsor serves as an adviser to the Company and therefore has not been and should not be vested with the authority to participate in the daily operations of the issuer or to influence its management's decisions. The sponsor shall impart upon the management the importance of adherence to the business plans as set out in the prospectus and implementing effective internal control measures to monitor the use of the IPO proceeds such that these funds are applied in accordance with the business plan as set out in the prospectus. The responsibilities of ensuring compliance fall squarely on issuers and their board of directors themselves. It is therefore impracticable for the sponsor, who is not a member of the issuer's management team nor board of directors, to monitor the use of funds and, in reality, the sponsor will become aware of any change in the application of IPO proceeds only as and when they are informed and provided with the relevant information by the issuer. The sponsor may make regular contacts with the issuer to enquire about its funding position and application of proceeds but it is the responsibility of the issuer to advise the sponsor on such matters. Accordingly, it should be appreciated that the sponsor's role is very much an advisory one rather than managerial.
10	Yes. Except that : 1. The 5% threshold shall be increased to 10%. 2. Some sponsor groups provide bridging finance to prospective issuers and so long as there is Chinese wall between the sponsor and the lender and the bridging finance is properly disclosed in the prospectus as an interest of the sponsor group in the issuer, the provision of such bridging finance should not affect the sponsor's independence. 3. In respect of 2. above, the Regulators should quantify the portion of the listing applicant's operation that is funded by a member of the sponsor's group beyond

	which the sponsor will no longer be regarded as independent to the listing applicant. 4. Regarding the independence of the directors and employees of sponsor group, persons that fall into this category should be confined to the directors and/or eligible supervisors and should not include other employees. In addition, the meaning of "close family members" is not clearly defined in the consultation paper which should be confined to spouse and children under the age of 18. Furthermore, the Regulators shall provide a list of events or circumstances which will constitute a "business relationship" as guidance for the purposes of this clause.
11	No. The sponsors should satisfy themselves that a listing applicant is suitable for listing and complies with the requirements under the Listing Rules and that the information disclosed in the prospectus is accurate and there is no material omission. However, as stated in 5. above, sponsors, auditors, lawyers and valuers have different areas of expertise and it is unreasonable and ineffective to enhance the quality of public documents merely by uplifting the responsibilities and penalties for sponsors and by putting in some vague clauses like "...no reasonable grounds to believe that..." to hold sponsors responsible for any negligence or faults or errors committed by other professional parties. **This is absolutely unacceptable to sponsor firms.** The Regulators should have a better understanding of the roles and responsibilities of different professional parties like auditors, lawyers and valuers and formulate and implement clear sets of guidelines for the responsibilities of these parties and the penalties if they fail to discharge their duties satisfactorily in conjunction with those for sponsors. Moreover, there is no clear definition of "reasonable investigations" to be carried out by sponsors. This will expose sponsors to the risk of being penalized by the Regulators even though the sponsors are of the view that they have carried out sufficient or more than sufficient due diligence but were deceived by IPO candidates. The above comments also apply to the additional responsibilities for IFAs in relation to the reports from other experts. Moreover, there is no reason to require the IFAs to make a declaration in their report regarding the due diligence they have performed in order to come up with their conclusions. There is no other jurisdiction that requires such declaration from IFAs. And again there is no clear benchmark for the level of due diligence which is considered by the Regulators as sufficient. Accordingly, the declaration will only expose the IFAs to the risks of being held responsible for the

	any unjustified opinions expressed as a result of any defaults of or inaccurate information provided by issuers. Such declaration is also superfluous as IFA letters are issued in the name of the IFA firms and signed off by the responsible officers already and, as such, both the firm and the responsible officer have taken on responsibilities for the IFA report as a whole. To improve the quality of the public documents, in particular prospectuses and IFA letters, the Regulators should consider the following approach : • Set out guidelines regarding the responsibilities of IPO candidates, issuers, sponsor firms, IFAs, auditors, lawyers, valuers and other professional parties or firms who give expert reports. • Set out the penalty to professional parties for failure to satisfy the requirements on due diligence. • Extend the list of approved sponsors and IFA firms to other professional parties including auditors, lawyers and valuers etc. • Due to the increasing concern about the accuracy and reliance of financial information of IPO candidates, require two firms of independent accountants to perform the role of reporting accountants and auditors so that we can have an independent opinion on the fair and reasonableness of the financial information as stated in the accountants' reports in the prospectus. The side-effect of this requirement is that it will increase the listing costs which is something IPO candidates may accept for obtaining an international listing status. • Set up a committee that comprises of representatives from the Regulators and professional bodies to study and decide on cases where professional parties may be found to have fallen short of the professional standards expected of them. To implement the above approach, the Regulators need to consult and discuss with sponsor firms and professional bodies such as Hong Kong Society of Accountants and Law Society of Hong Kong regarding the roles and responsibilities of these professional parties, scope of due diligence they are expected to perform and the penalties for failing to accomplish such tasks. For those professionals who have not yet established a professional body such as valuers, the Regulators may suggest or encourage them to establish a professional body for the purposes of establishing, monitoring and enforcing professional standards.	
12	No.	

	Clause	
	9	Sponsor firms should have the right to terminate its role as sponsors on normal commercial grounds and should notify the Regulators and public (for listed issuers) of such termination and the reasons thereof. There is **no reason and it is unacceptable** to the sponsor firms that they shall have the burden of proving the existence of exceptional circumstances which, in any event, the Stock Exchange has not been explicit about what are those circumstances. The Regulators can require that certain termination events which are in line with commercial practice and acceptable to the Regulators be included as mandatory provisions for all sponsor agreements.
	11	The sponsor should assist the issuers in ensuring that the public documents (after listing) are in compliance with the Listing Rules. However, the role of sponsors should not be extended to (a) include the preparation of any documents required by the Listing Rules during the post listing sponsorship period which should be the responsibility of the board of directors of issuers (unless otherwise agreed between the sponsor and the issuer); and (b) to ensure such documents comply with all relevant legislation which is the responsibility of the issuers who may wish to seek separate legal advice. The purpose of post-listing sponsorship is to provide guidance to issuers and their directors for complying with the requirements for being a listed company/directors of listed companies. The arrangement is a transitional measure and does not mean to be permanent. The ultimate goal is to enable the issuers and their directors to perform their duties on their own. In other words, the issuers and their directors will be held fully responsible if they fail to comply with requirements of the Listing Rules or other legislation after the post-sponsorship period. Therefore, the issuers and their directors should take the overall responsibility for all public documents once they become a listed company. **The Regulators are advised to carefully and thoroughly consider the objectives of the post-listing sponsor and to avoid any over-reliance of issuers on sponsors by putting excessive responsibilities on sponsors for the purpose of regulatory and administrative convenience which is a short-sighted and irresponsible attitude.**
	19	It is fine for the Regulators to rely on the due diligence performed by

		sponsors provided that sponsors can in turn rely on the work done by other professional parties. Regarding information in non-expert sections of the prospectus, it must be the legitimate expectation of sponsors that they have satisfactorily discharged their duties in relation to due diligence where they have addressed all the queries raised by the Regulators during the prospectus vetting process. The Regulators can require sponsors or other professional parties to perform additional procedures and can refuse to submit the IPO application to the Listing Committee if such requirements are not being fulfilled. The scandals that happened during the past 12 months were often related to commercial crimes and accounting frauds which required extensive investigations by police departments or other law enforcement bodies. The Regulators should not mix up the roles of sponsors and these government bodies and should not assume that sponsors have the same power or resources as these bodies. The danger is that sponsors are expected to conduct detailed, extensive and intrusive investigations which are beyond their means and the nature of their commercial appointment as advisers, as opposed to due and careful enquiries within business decency which could be reasonably expected of them.
	20	At present all placees are required to declare that they are independent of controlling shareholders of IPO candidates or issuers. The Regulators can require all underwriters or sub-underwriters to provide similar declarations. The Regulators can maintain a list of securities companies/individuals that are prohibited from participating in any primary or secondary market fund raising activities/subscribe any securities in primary or secondary fund raisings if they are found to have been convicted of market manipulation activities. It does not make sense to require sponsors to make reasonable "investigations" on the independence of all the public shareholders, in particular whether they are genuinely unconnected to and not financially supported by any connected person, not to mention those sizable fund raisings that could have hundreds or thousands of public shareholders as they do not have a direct relationship with the ultimate placees. Again, the Regulators should not assume sponsors to have the power, or to perform the functions, of commercial crime bureau.
	21(d)	Auditors are better trained professionals to assess the internal control

		procedures and accounting and management information systems. In fact, internal auditors are a group of professionals that study and implement such procedures and systems. For highly automated enterprises, such tasks are undertaken by professional accountants, internal auditors and information technology experts. The Regulators can consider requiring a report from reporting accountants regarding the internal control procedures and accounting and management information systems of IPO candidates. The Regulators may also require the IPO candidates to recruit a team of internal auditors and information technology experts with recognized qualifications who shall report to the audit committee on matters relating to internal control and management information systems. It does not make sense for the Regulators to require sponsors to investigate and report on matters which sponsors do not have the relevant expertise.
	22(g)	Such assessment could be very subjective.
	23	The Regulators have to clarify the purposes of such investigations : • Whether an IPO candidate will be regarded as not suitable for listing if its controlling shareholder or its associates have the track record of/are in the course of legal proceedings regarding any civil or criminal actions. • Whether it is required to make corresponding disclosure in the prospectus of the records of legal proceedings/outstanding legal proceedings of the controlling shareholder. If so, the Regulators should consider whether such disclosure would constitute discrimination against the controlling shareholder which might result in an unjustified and unfavourable impression towards the IPO candidate and the fund raising as a whole.
	24(c)(d)	Sponsors can make the request of interviewing third party customers, suppliers, creditors and bankers. However, there is no guarantee that such requests would be entertained. The Regulators have assumed that these third parties would always offer their full cooperation to the IPO candidates and the professional parties in respect of the IPO applications, which is very often not the case in real life..
	24(f)	It is a standard procedure to enquire and understand the production

		process and make corresponding disclosure in prospectus, say in the form of production flow chart. The role of sponsors and disclosure in this respect are to provide information on the production process instead of analyzing the production methods. Sponsors are not supposed to form a view or to give recommendations on production methods which is not within their areas of expertise and should be carried out by industrial engineers.
	24(n)	Technical feasibility of new products should be assessed by relevant engineers or consultants. The Regulators may require IPO candidates to submit a technical feasibility report from independent engineers or consultants which will result in additional listing costs. It does not make sense to require sponsors to "investigate" the technical feasibility of, say a new medicine, optic fibre, global positioning system or satellite which again is outside their areas of expertise.
	25(a)	It is the responsibility of experts to state their background and expertise by way of curriculum vitae or corporate brochure and the Regulators may require these experts to provide a declaration in respect of their professional qualifications. There is no reason for sponsors to be suspicious about the professionalism of other experts at the first place and to make any "investigation", as opposed to general enquiry, in that respect.
	25(c)	Sponsors should review the expert sections as proposed under clause 25(d) and enquire with the expert or professional regarding the context in which the assumptions and qualifications made in their expert reports. However, as stated in the above paragraphs, sponsors do not possess the relevant expertise to make such expert reports or else issuers would not need to retain the service of other professional parties for their expertise and therefore sponsors are not in a position to assess the reasonableness of assumptions used and any qualifications made in the expert report. It is not a matter of someone doing a job for another who is perfectly able to do it himself. There is no doubt that the opinion of an expert should prevail over the views of sponsors on areas which the former has the relevant expertise, unless the Regulators think otherwise.
	25(e)	It is the responsibility of experts to declare their independence and, as

		reasonable persons, the Regulators and sponsors should be entitled to assume that these experts have integrity. It is **unreasonable** to ask sponsors to confirm the independence of other experts. **The Regulators should never try to hold the sponsors responsible for all the work undertaken by and the integrity of all other professional parties for the purpose of regulatory and administrative convenience which is an unreasonable and irresponsible attitude.**
	28	The Regulators should hold issuers, directors and connected persons solely responsible for any connected transactions and it is the responsibility of the issuers, directors and connected persons to ensure that the connected transactions are conducted on arm's length basis and it is the responsibility of the issuers' audit committee and independent board of directors to monitor that the connected transactions are being conducted at arm's length and on normal commercial terms. The role of ongoing sponsor is to advise the issuer on compliance with Listing Rule's requirements on connected transactions instead of investigating or monitoring the carrying out of these transactions. **The Regulators are advised to carefully and thoroughly consider the objectives of the post-listing sponsor and to avoid any over-reliance of issuers on sponsors by putting excessive responsibilities on sponsors for the purpose of regulatory and administrative convenience which is a short-sighted and irresponsible attitude.**
	29	It is the responsibility of issuers, not sponsors, to ensure the completeness and accuracy of disclosure in all public documents. It is alright to request sponsors to make enquiries, but not investigations, in that respect. See comments on clause 11, as reasonable investigations could mean a scope far beyond what is generally accepted by the business community as due and proper enquiries that the issuer and its management are expected to respond.
	30	IFAs should decide on the review procedures and any information and documents which they may require from issuers based on their fair judgment. To request IFAs to "obtain all information and documents" is already beyond the meaning of "reasonable steps". Regarding the role of IFAs on expert report (clause 30(d)), please refer to comments on clause

		25(c).
	33(b)	This requirement should apply only to sponsor firms if the eligible supervisor is an ex-employee of that firm.
13	No. There is no good reason to require sponsors and lead underwriters to make such statement except that the Regulators could extend the liability of sponsor firms and underwriters which otherwise may not exist under current statutes. The Regulators **must** get the support of sponsor firms before imposing this **unreasonable** requirement which is favourable to the Regulators in terms of regulatory and administrative convenience whilst exposing sponsor firms and lead underwriters to crushing liabilities. The Regulators **must** justify this requirement given that there is no such requirement in UK which does not require sponsors to take overall responsibility. It is also **unreasonable** to extend statutory liability to sponsors for material misstatements in prospectus without considering the cause of such misstatements which could be due to deception by IPO candidates/issuers or under-performance of sponsors in carrying out due diligence. In the former case, it is absolutely unreasonable to require sponsors to bear liability of any kind whilst in the latter case the Regulators can investigate the working files of sponsors and remove them from the list of approved sponsors if they are found to have fallen far short of the standards expected of sponsors but in any case there is no reason to expose them to any criminal liability unless they are proven to have deceived the Regulators and investors by making intentional misstatements in the prospectus. In this connection, it is important for the Regulators to set out a consistent and fair basis for assessing the performance of sponsors. As stated in the comments above, the Regulators should agree with sponsors and other professional firms on the set of Review Procedures by which sponsorsand professional parties are bound. The Regulators should inform the market by publishing the findings and reasons concerning the removal of any sponsor or eligible supervisor from the list of acceptable persons.
14	No. Please refer to comments above in relation to sponsors.
15	Yes.

16	Yes
17	(a) to (d) : Yes
18	Not applicable.