YU MING INVESTMENT MANAGEMENT LIMITED
禹銘投資管理有限公司

073191

DATE 30th July, 2003

Hong Kong Exchange and Clearing Limited
Listing Division
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Securities and Futures Commission
Corporate Finance Division
8th Floor
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Dear Sirs,

Re : Consultation Paper – Sponsors and Independent Financial Advisers

Please find enclosed our comments on the above consultation paper.

Yours faithfully
For and on behalf of
YU MING INVESTMENT MANAGEMENT LIMITED

Warren Lee
Director

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Consultation Paper

on the regulation of
Sponsors and
Independent Financial Advisers

Comments from

Yu Ming Investment Management Limited

30th July 2003

An Overview

The consultation paper started off with the Exchange denying its goal to guarantee quality (paragraph 16 page 8). This philosophy is right, but not practised : the rest of the consultation paper is all dedicated to quality assurance.

The Code of Conduct for Sponsors and Independent Financial Advisers ("IFA") is complete utopia. It suggests that the Exchange does not know the real business world. Based on the Code of Conduct, the top ten US investment banks can pack up and go home. They do not seem to meet the "effective compliance" and "step to avoid conflict of interests" criteria under the proposed Code of Conduct. If they are let in, it's at the Exchange's discretion. Discretion is not something the market trusts or wants.

The extent of work expected of sponsors and IFAs in the Code of Conduct belies the stated intent of the Exchange of not guaranteeing quality. Only that the guarantee is shifted entirely to the sponsors. Why blame all on the sponsors? Why not just improve enforcement and lock up the directors?

100% Quality Assurance?

The 100% quality control expected by the Exchange of the sponsor on new listing applicants is an unattainable task even at infinite costs.

To carry out endless due diligence as a means to prevent false information in a prospectus is implausible, impractical and ineffective. Where should due diligence stop? Reasonableness is the yardstick, but when a practitioner is in disagreement with the Exchange as to how reasonable is reasonable, we are back to square one – the expectation gap. For instance, in verifying someone's education, is the sighting of a degree certificate sufficient? Or should a sponsor authenticate the signature of the university registrar issuing the certificate?

The best way is always the simple way

The most direct and effective way to prevent false information in the non-expert sections is to punish the source of false information – directors of listed companies. Only directors know whether they lied in a prospectus. To ensure the honesty of a director involves never ending investigations by the sponsor. It increases costs and time for a Hong Kong listing to an uncompetitive level. Yet it does nothing to enhance or ensure quality.

Business Acumen

The requirement for a sponsor to gauge directors' business acumen is naïve. How can a sponsor judge the business acumen of a businessman? If business acumen is to be considered at all, does the Exchange intend to bar young successors of inherited business, or government appointees such as the Exchange's CEO Mr. Kwong Ki-Chi, a career civil servant with no business acumen?

Discretion is Unacceptable

The Exchange has too much discretion over the eligibility of the sponsor. There is no transparency as to how discretion would be exercised by the Exchange. Appeal creates bureaucracy and committees - it is not a preferred alternative. Discretion is the main source of corruption, and should be eliminated altogether. Historically, the Exchange has won little market approval when exercising discretion.

A sponsor's eligibility should depend on entirely hard and fast criteria.

Big League Investment Banks Already Banned?

In April 2003, the Task Force comprising individuals from the New York Stock Exchange, the Securities and Exchange Commission (the "SEC"), NASD Inc., the North American Securities Administrators Association, the New York Attorney General's Office, and other state securities regulators found that the top ten investment banks in the United States had engaged in misconducts, resulting in a US$1.4 bln fine.

These firms settled the enforcement actions without admitting or denying the allegations, facts, conclusions or findings contained in the settlement documents.[1]

The misconducts (described in more details in next section of this paper) are serious, as evidenced by the magnitude of the fine, and would render each of these investment banks ineligible to act as a sponsor in Hong Kong. The misconducts include (i) encouraging conflicts of interest through the use of analysts' research as a tool to pitch investment banking business; (ii) IPO spinning; (iii) secret payments to other investment banks to write favourable research on companies; and (iv) failure to preserve electronic communications.

It is only reasonable to assume that the investment banks involved in those serious misconducts and all their associates and subsidiaries are not eligible sponsors. If in the

[1] Congressional Testimony by Federal Document Clearing House – Statement of Richard A. Grasso Chairman and CEO New York Stock Exchange Inc., 7th May, 2003

unlikely event that they are still eligible in the view of the Exchange, then what type of misconducts would the Exchange consider serious enough to disqualify a merchant bank from being a sponsor? And what good are the proposed eligibility criteria? Again, the tyranny of the Exchange's discretion comes to mind.

Reentry to the Sponsor List

When a sponsor dropped out of the sponsor list, the only means to get back to the list is by poaching qualified Eligible Supervisors from other sponsors. This would not sting big banks like Morgan Stanley and Goldman Sachs to hire 4 Eligible Supervisors at twice the market rate, but it would be disastrous for small firms. In any event, who would want to join a small firm who has been bumped from the list. Furthermore, smaller firms, desperate to stay on the list, would bring in issuers irrespective of quality. This is exactly the opposite result that the Exchange desires.

The dropout conditions should be made reasonable and practical. The proposed conditions are life-threatening to smaller firms, and encourage dodgy practices simply to stay alive. Thoughts must also be given to facilitate reinstatement, which as now drafted appears all but impossible.

Is a Sponsor needed at all?

If, according to the principle we promote, only directors are accountable for information in a prospectus, then the question of the purpose of a sponsor arises. Exactly what is it that a sponsor can do that a company's lawyer cannot? Any corporate lawyer who can read the Listing Rules can "sponsor" a listing. In practice, an underwriter takes the sponsor role and fee for granted, out of its superior bargaining power derived from it underwriting commitment, but not out of necessity.

Why do we need a sponsor? The sponsor system was designed originally to protect the business interests of the members of the Exchange so that only members or their subsidiaries can sponsor listings. But the Exchange is now a listed company and the system must change with time.

Only the Smartest Crooks Allowed

To circumvent the new rules, crooks will devise foolproof schemes to cheat sponsors. The inherent increase in cost as a result of the Exchange's proposal will deter the average scrupulous businessmen and small to medium businesses, but will let in the cleverest cons, who will obtain a listing at any cost because it suits them to have the quality label the Exchange puts on listed companies.

Don't Send the Wrong Message

By requesting the sponsor to carry out unrealistic and endless due diligence, the Exchange is declaring "The water is safe". The fact is, no water is safe in the real world. No matter what you do, no one can conquer natural instincts like fraud or greed. The Exchange should not make the attempt.

Investors are not naïve, they know the risks. They just blame it on the regulators, who bring it upon themselves by pretending to provide something they don't have – a guarantee of quality.

Quality assurance is not within the remit of the Exchange, therefore not something to strive for. Prominent risk disclosure will be adequate.

Above all, the market cannot accept the notion that the Exchange seeks to have the roles of prosecutor, judge and executioner lumped into one and bestows it upon itself, all in the vain name of promoting quality.

Comments on Part B

Paragraphs 50-52

To maintain a list is acceptable, but the Exchange should not have any discretion to accept or reject an application to be a sponsor or IFA. The rules should be square and fair, hard and fast. A merchant bank either meets the criteria, or it does not. Discretion is the main source of corruption, and should be eliminated altogether.

Paragraph 54

The circumstances under which an individual would be listed as an "unacceptable person" must be made clear. For instance, Yu Ming Investment Management Limited is often at odds with the Listing Division. Hopefully that will not be considered unacceptable.

There must be a mechanism for an "unacceptable person" to return to business as a sponsor or IFA.

Paragraphs 75-76

1. If "exempt listing document" and "investment company" are not recognized as significant transactions, then does a merchant bank have to be on your list of "acceptable sponsors" to carry out those assignments?

2. If so, then how can merchant banks specializing in "exempt listings" and "investment company listings" carry out those assignment? By definition, those specialized merchant banks know best about exempt listings and investment company listings. It would be wrong and unfair to exclude them from carrying out this work.

3. Does a new listing by way of placing only but involves registration under the Companies Ordinance count as an IPO? If not, why not? Placing is one of the methods of listing under Chapter 8 of the Listing Rules.

4. Does a VSA treated as a new listing involving placing and registration under the Companies Ordinance count as an IPO? If not, why not?

5. Does a VSA treated as a new listing involving public offering and registration under the Companies Ordinance count as an IPO? If not, why not?

Paragraph 80

In assessing whether a sponsor is able to discharge its obligation, the Exchange will consider, inter alia, effective supervisory, monitoring and reporting controls, effective compliance function, steps to avoid conflicts of interest, adequate competence, professional expertise and human and technical resources and proper books and records.

If the Exchange is serious about adopting the above criteria in admitting a merchant bank as a sponsor, the ten major US investment banks will not meet the "effective compliance" and "step to avoid conflict of interests" criteria under your proposed Code of Conduct.

In April 2003, the Task Force found that Bear, Stearns & Co. Inc., Credit Suisse First Boston LLC ("CSFB"), Goldman, Sachs & Co. ("Goldman Sachs"), Lehman Brothers Inc. ("Lehman"), J.P. Morgan Securities Inc. ("J.P. Morgan"), Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Morgan Stanley & Co. Incorporated ("Morgan Stanley"), Salomon Smith Barney Inc. ("Salomon Smith Barney"), UBS Warburg LLC ("UBS"), and U.S. Bancorp Piper Jaffray Inc. ("Piper Jaffray") had engaged in misconducts, resulting in a US$1.4 bln fine. These firms settled the enforcement actions without admitting or denying the allegations, facts, conclusions or findings contained in the settlement documents.

The misconducts are serious, as evidenced by the magnitude of the fine, and would render all of these investment banks and their associates and subsidiaries ineligible to act as sponsor in Hong Kong.

Just a few examples would highlight the seriousness of the offences :

Conflicts of Interest

1. The Task Force determined that "each" firm encouraged an environment in which research analysts were repeatedly subject to inappropriate influence by investment bankers, and the analysts' objectivity and independence was compromised as a result of that influence. The firms' policies and procedures failed to protect research analysts from the significant investment banking influences and conflicts of interest.

2. All of the ten investment banks used analysts' research as a marketing tool to generate investment banking business, and paid its analysts in part based on the investment banking business they helped to procure.

3. Each investment bank under investigation produced e-mails, research reports, notes, and other documents, all of which provided evidence of conflicts of interest and other violative conduct. The enforcement actions against Salomon Smith Barney and CSFB contained fraud charges.

Improper Practices

4. At least two of the investment banks, Salomon Smith Barney and CSFB, engaged in "spinning", which is the improper allocation of "hot" IPO shares to executives of investment banking clients with the expectation that these executives would steer investment banking business to the firm.

5. Morgan Stanley was found to have made secret payments to other investment banks to write favourable research on companies Morgan Stanley had underwritten to help create positive sentiment on those companies.

Supervisory Deficiencies

6. Deutsche Bank, Goldman Sachs, Morgan Stanley, Salomon Smith Barney, and Piper Jaffray failed to preserve electronic communications in a manner consistent with the Securities Exchange Act, which amounted to supervisory deficiencies. In December 2002, the investment banks agreed to settle the enforcement actions for a fine of US$1.65 million each.

The judgmental criteria require discretion from the Exchange. However, the market does not have faith in the Exchange's discretion. The rules should be square and fair, hard and fast. A merchant bank either meets the criteria, or it does not. Discretion is the main source of corruption, and should be eliminated altogether.

Paragraph 93

1. What do you mean by the "relevant" member of a group?

2. Your suggestion is an offence of the secrecy provisions of the SFO.

3. To disclose whether a merchant bank is a target of investigation is also prejudicial. Some of the Securities and Futures Commission's ("SFC") investigations and prosecutions ended up the defendant being found innocent. It would taint the reputation of innocent merchant banks to disclose such investigations or prosecutions during the process. Business will be hurt.

Paragraph 94

A current suspension or revocation of license would make an investment bank ineligible to be a sponsor. How about a US$1.4 bln fine by the SEC and the New York Attorney-General for investment banking misconducts?

Paragraph 97

To ask an Eligible Supervisor to give an undertaking that the sponsor firm complies with its obligation is onerous. If the firm breaches the rules, punish the firm, or the person who directly causes such breaches, not every Eligible Supervisor in the firm. This would be uncivilized.

Paragraph 108

1. The two directors should be executive directors who are involved in the daily management and operation of the listed issuer.

2. Either (a) or (b) shall be sufficient.

Paragraph 137

It is acknowledged by the Exchange that actual extent of due diligence will depend on the circumstances, and is a question of judgment. So what are the circumstances, and who should exercise the judgment. Again, we are back to square one – the expectation gap. The sponsor may think it has done sufficient in the circumstance, based on its judgment. But the Exchange disagrees. Then the Exchange can strike off the sponsor from the list, and let the sponsor grovel to the Exchange and its committees for an appeal. The prosecutor, judge, and executioner all embodied into one – what a thought!

Paragraph 146

1. Reasonableness is the yardstick, but when a practitioner is in disagreement with the Exchange as to how reasonable is reasonable, we are back to square one – the expectation gap. For instance, in verifying someone's education, is the sighting of a degree certificate sufficient? Or should a sponsor authenticate the signature of the university registrar issuing the certificate?

2. The Exchange should not expect due diligence to prevent frauds, which are most of the time carefully designed.

3. How does due diligence "ensure" no omission of material facts? If the key man of issuer does not tell you he has prostate cancer and would not live for another year, how does the Exchange expect the sponsor to know? What due diligence can be done to find out?

4. If sponsors have to do verification on the expert section, it means either (i) the Exchange thinks other experts are not professional or independent enough (then why engage them?) or (ii) works of sponsors and other experts would be redundant (then unnecessarily increase cost of new listing).

5. It would send a wrong message to the investors that sponsors have screened and given a guarantee on the quality of the new applicants.

Paragraph 151

1. How appropriate is appropriate? Again, we are back to square one – the expectation gap. The sponsor may think it has made the "appropriate" enquiries, but the Exchange disagrees. Then the Exchange can strike off the sponsor from the list, and let the sponsor grovel to the Exchange and its committees for an appeal.

2. How extensive an investigation is enough? When a practitioner is in disagreement with the Exchange as to how much investigation is enough, we are back to square one – the expectation gap. For instance, in verifying someone's education, is the sighting of a degree certificate sufficient? Or should a sponsor authenticate the signature of the university registrar issuing the certificate?

3. Reasonableness is the yardstick here, but when a practitioner is in disagreement with the Exchange as to how reasonable is reasonable, we are back to square one – the expectation gap. For instance, in verifying someone's education, is the

sighting of a degree certificate sufficient? Or should a sponsor authenticate the signature of the university registrar issuing the certificate?

Paragraph 170

Complaints must not be anonymous.

Paragraph 178

There should be a mechanism for expelled sponsors or IFAs to return to the list again.

Comments on Code of Conduct

Paragraph 7

Most of the big investment banks in the United States would not be able to meet the requirements set out in this paragraph, including effective supervisory, monitoring and reporting controls, effective compliance function, maintain proper books and records.

Does the Exchange intend to let them off? Or does the Exchange believe the billion dollars of fine for improper practices are immaterial? If so, how does the Exchange plan to treat breaches of local small to medium sized merchant banks?

Paragraph 12

Most of the big investment banks in the United States would not be able to meet the requirements set out in this paragraph, including steps to avoid conflict of interests.

Does the Exchange intend to let them off? Or does the Exchange believe the billion dollars of fine for improper practices are immaterial? If so, how does the Exchange plan to treat breaches of local small to medium sized merchant banks?

Paragraph 17

How appropriate is appropriate? Again, we are back to square one – the expectation gap. The sponsor may think it has made sufficient enquiries to the "appropriate" circumstance, but the Exchange disagrees. Then the Exchange can strike off the sponsor from the list, and let the sponsor grovel to the Exchange and its committees for an appeal.

Paragraph 19

The sponsor is expected to conduct "intrusive" investigations. This is completely over and above what can be expected from a business undertaking. Even auditors are not required to do that. This is a job for police and spies, with omnipotent power.

Paragraph 20

1. Apart from asking underwriters and connected persons for confirmation, how else does the Exchange expect the sponsor to satisfy itself that the placees are independent? A clear guideline should be given here.

2. It would also be impossible for sponsors to ascertain whether persons from public subscription are independent or not. The Sponsor simply cannot check if they lied. Cannot check source of funds without statutory power. It would help if the Exchange can negotiate that power for the sponsors.

Paragraph 21

The Exchange should demonstrate how a sponsor should go about to investigate the integrity of a director? Has the Exchange investigated the integrity of Mr. Liu Jinbao before the Exchange appointed him as a director?

Paragraph 22

1. The requirement for a sponsor to gauge directors' business acumen is naive. Who says a sponsor is qualified to judge the business acumen of a businessman who runs a business many times the size of the sponsor? If business acumen is to be considered at all, does the Exchange intend to bar young successors of inherited business, or government appointees such as the Exchange's CEO Mr. Kwong Ki-Chi, a career civil servant with no business acumen?

2. Are sponsors supposed to do a global search for court actions and judgments against a director? Where does a sponsor stop? Nigeria? South Africa? Switzerland?

3. Inquiries with regulatory bodies are but a joke. Just imagine what the Exchange, the SFC, the Monetary Authority and the China Securities Regulatory Commission would reply to an enquiry of Mr. Liu Jingbao's status of investigation, in the event an issuer is to appoint him as a director in a new listing?

   Again, which jurisdiction should the sponsor check? Nigeria? South Africa? Switzerland? London? Dublin? Oslo? Amsterdam? New York? Tokyo?

4. Is time spent on playing golf counted as time devoted to the business of the issuer? What about time spent daydreaming in the office? How can one tell?

5. What kind of past conduct do you refer to? An issuer intends to invite Mr. Anthony Leung to join its board of directors, can the Exchange tell us whether his past conducts are acceptable to the Exchange?

Paragraph 23

Complete utopia.

Paragraph 24

Of course the sponsor will satisfy itself that the issuer will apply the proceeds for business expansion or as general working capital. But the problem always occurs after the listing.

Paragraph 25

1. Please elaborate how to judge whether a PricewaterhouseCoopers' partner has the expertise he claims to have?

2. After the scandals like Yue Fung, Guangnan, etc, does the Exchange consider that the Big Four are not qualified to do audit work?

Paragraph 30

1. Please revise your Listing Rules to permit publication of the circular 21 months after the announcement. 21 days are certainly not enough to perform a comprehensive due diligence. Unless all companies are Tom.com.

2. Pricing is a highly confidential information. Not easy to obtain from the public domain or almost impossible to obtain from competitors.

3. The Exchange asks a non-expert – the sponsor – to assess the appropriateness of cope of work, reasonableness of any assumptions and projections. What about an expect providing DNA related work valuation? How on earth can a sponsor cope with the highly technical assumptions?

ANNEX 3

SUMMARY OF QUESTIONS

ACCEPTABLE SPONSOR FIRMS

(Paragraphs 50 to 52 of Part B of the Consultation Paper)

We propose that to be eligible to act as a sponsor to a new applicant or a listed issuer, the firm is required to be accepted by the Exchange for such purposes and admitted to a list of acceptable sponsors maintained by the Exchange. The Exchange may refuse an application as a sponsor or cancel a sponsor's admission to the list if the Exchange considers that the sponsor or applicant does not satisfy the criteria established in order for the firm to be included on the list of acceptable sponsors maintained by the Exchange. We propose that all first instance decisions in relation to eligibility on application; on-going eligibility and independence of a sponsor should be made by the Listing Division and subject to review, if necessary, by the Listing Committee.

Q.1 Do you agree with our proposal?

☐ *Yes*

☒ *No*

Please state reason(s) for your view

See attached sheet

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 as 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.

ACCEPTABLE INDIVIDUALS

(Paragraphs 54 to 59 of Part B of the Consultation Paper)

We propose that only individuals who:

(a) are appropriately licensed/registered under the SFO;

(b) work for a sponsor firm or IFA firm (whichever is applicable) and are eligible supervisors or perform work under the supervision of an eligible supervisor; and

(c) are not on the list of unacceptable individuals

may do sponsor work or IFA work.

Q.3 Do you agree with our proposal?

☐ *Yes*

☒ *No*

Please state reason(s) for your view.

See attached sheet

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.

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Qualification and experience criteria of eligible supervisors
(Paragraphs 67 to 79 of Part B of the Consultation Paper)

We propose to merge the requirements relating to qualification and experience criteria for Principal Supervisors and Assistant Supervisors into a single new category called "eligible supervisors". We also propose to recognize overseas experience derived from recognized overseas exchanges (such as NYSE, NASDAQ, SGX, ASX, London Stock Exchange and Toronto Stock Exchange) for the purposes of assessment of individuals. Accordingly, the experience requirement of the four eligible supervisors required in each sponsor firm is proposed to be as follows:

- must have a minimum of 4 years of relevant corporate finance advisory experience derived in respect of companies listed on recognized stock exchanges or from other channels, such as corporate finance experience gained from employment with an issuer listed on the Exchange;

- substantive involvement in at least 3 significant transactions, which have been completed. At least one of those transactions must be in respect of a company listed on the Exchange. At least one transaction must have been an IPO and at least one of the transactions must have been completed within the previous two years. These requirements will be on-going requirements.

A substantive role means a role as a member of the sponsor firm's core transaction team in delivering or managing the delivery of one or more of the major components of due diligence work undertaken in respect of an engagement.

The definition of "significant transactions" is proposed to include: (i) IPOs; (ii) very substantial acquisitions or disposals (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iii) major transactions (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iv) connected and major transactions (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (v) a rights issue or open offer by a listed company (or their equivalent under the rules applicable to listing on other recognised stock exchanges); and (vi) takeovers subject to the Takeover Code (or its equivalent in other recognised jurisdictions). Guidance will be provided to clarify that transactions involving the production of an exempt listing documents and the listing of investment companies will not be regarded as significant transactions.

We propose that the qualification and experience criteria for the two IFA eligible supervisors in an IFA firm be the same as for sponsor eligible supervisors save for the one IPO transaction experience requirement.

Q.5 Do you agree with our proposals?

☐ *Yes*

☒ *No*

Please state reason(s) for your view.
See attached sheet

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

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

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

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

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

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

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

Q.6 Do you agree with our proposal?

☐ *Yes*

☒ *No*

Please state reason(s) for your view.
See attached sheet

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.

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

☒ *Yes*

☐ *No*

Please state reason(s) for your view.

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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.
See attached sheet

APPOINTMENT

(Paragraphs 98 to 113 of Part B of the Consultation Paper)

We propose to retain the requirement that new applicants (including deemed new applicants) will be required to appoint a sponsor to assist them through the application process.

After the new applicant is listed, we propose that:

(a) For Main Board: the new applicant must appoint a sponsor firm as a financial adviser for a period ending on publication of the financial results for the first full financial year after the listing.

(b) For GEM: the new applicant must appoint as sponsor firm as a financial adviser for at least the remainder of the financial year during which the listing occurs and the 2 financial years thereafter (i.e. we propose to retain the period stipulated in the existing GEM Listing Rules).

The issuer will not be obliged to appoint the same sponsor firm who handled their IPO. During this period, the issuer will be obliged to seek, on a timely basis, advice from the sponsor in relation to a number of prescribed events. The prescribed circumstances and services are proposed to include the publication of any regulatory announcement; publication of any circular or financial report; where a notifiable transaction (connected or otherwise) is contemplated including share issues and share repurchases; and monitoring the use of the proceeds and adherence to the business plans as detailed in the prospectus.

We also propose to retain the discretion to direct an issuer to appoint a sponsor firm to provide it with advice for any period it specifies. This discretion may be used in the event of a breach of the Listing Rules or investigation of a possible breach of the Listing Rules.

We also propose to retain the requirement that listed issuers are required to appoint an IFA in relation to connected party transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain form voting. We will clarify that an IFA must be a firm either on the list of acceptable Sponsors or list of acceptable IFAs.

Q.9 Do you agree with our proposals?

☒ *Yes*

☐ *No*

Please state reason(s) for your view.

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INDEPENDENCE

(Paragraphs 114 to 123 of Part B of the Consultation Paper)

We propose that a sponsor must not act for any new applicant or listed issuer, whether as a sponsor or joint sponsor, from which it is not independent. The Exchange will expect a sponsor to consider a broad range of factors that might impact on its ability to act independently of an issuer. Some of these factors are considered below, but sponsors should note that this list of factors of when a sponsor will not be regarded as independent is not exhaustive and the existence of other relationships or interests which might give rise to a material interest in the success of a transaction will be considered. The specified circumstances are:

- a sponsor or any member of the sponsor's group is holding more that 5% of the issued share capital of a new applicant;

- the fair value of shareholding referred to above exceeding 15% of the consolidated net tangible assets of the sponsor group;
- a sponsor or any member of the sponsor's group is controlling the majority of the board of directors of the new applicant;
- a sponsor is controlled by or is under the same control as the new applicant;
- 15% or more of the proceeds raised from an IPO is applied to settle debts due to a member of the sponsor's group;
- a significant portion of the listing applicant's operation is funded by the banking facilities provided by a member of the sponsor's group;
- where a director or employee of the sponsor or a close family member of either a director or employee of the sponsor has an interest in or business relationship with the new applicant; and
- where the sponsor or a member of the sponsor's group is the new applicant's auditor or reporting accountant.

In addition to fulfilling the independence requirement as mentioned above, we also propose that the Exchange will generally preclude from concluding that an IFA is independent if it has served as a financial adviser to the relevant listed issuer, its subsidiaries or any of its connected persons any significant assignment within two years of appointment.

We also propose to require sponsors and IFAs to submit a declaration in respect of their independence, addressing each category of potential conflict, at the beginning of any assignment, which requires the appointment of a sponsor or an IFA.

Q.10 Do you agree with our proposals?

☒ *Yes*

☐ *No*

Please state reason(s) for your view.

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RESPONSIBILITIES

Reasonable investigations
(Paragraphs 124 to 152 of Part B of the Consultation Paper)

We propose that the Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that:

- the new applicant is suitable for listing, the new applicant's directors appreciate the nature of their responsibilities and the new applicant and its directors can be expected to honour their obligations under the Exchange Listing Rules and the Listing Agreement;

- "non-expert sections" contained in the new applicant's listing application and listing documents are true and that they do not omit to state a material fact required to be stated or necessary to avoid the statements being misleading; and

- there are no reasonable grounds to believe that the "expert sections" contained in the new applicant's listing application and listing documents are not true or omit to state a material fact required to be stated or necessary to avoid the statements being misleading.

We propose that sponsors be required to comply with a Code of Conduct that will set out, among other things, the minimum due diligence a sponsor would be expected to undertake to satisfy the obligations to conduct reasonable investigations we propose including in the Listing Rules.

We propose that the Main Board and GEM Listing Rules be amended to require IFAs:

- to take all reasonable steps to satisfy themselves that the terms and conditions of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole and that there are no grounds to believe that any expert advice or opinion relied on in relation to the transaction are not true or omit a material fact; and

- to make a declaration in their report of the due diligence they have performed in order to reach a conclusion that the terms of the relevant transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole.

Q.11 Do you agree with our proposals?

☐ *Yes*

☒ *No*

Please state reason(s) for your view.
See attached sheet

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.
See attached sheet

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

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

We propose that both sponsors and lead underwriters (where the latter are different from the former) should make a statement in listing documents regarding the extent of their due diligence which would track the form of statement currently given to the Exchange on a private basis by sponsors subject to the modification noted below. A sponsor is also expected to ensure that the document presents a fair impression of the issuer and that it has been written in plain language. The sponsor's due diligence obligation is modified in respect of reports and information published in a listing document with the consent of an expert. The form of declaration proposed recognises this distinction. In respect of "non-expert sections" of a listing document we propose that the following statement should be made "[Sponsor firm and underwriter] confirm(s), at the date of this document, that after reasonable investigation it believes/ they believe and have reasonable grounds to believe that the information set out in this listing document at [make specific references] is not materially false or misleading" and, in respect of "expert sections", an alternative test of due diligence that "it/they have no grounds to believe and do not believe that the information set out in those sections of the listing document at [make specific references], which have been prepared and authorised by [name], is materially false or misleading".

Q.13 Do you agree with our proposals?

☐ *Yes*

☒ *No*

Please state reason(s) for your view.

See attached sheet

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.

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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.

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COMPLIANCE AND SANCTIONS

(Paragraphs 171 to 181 of Part B of the Consultation Paper)

We propose that sponsors and IFAs and their eligible supervisors and staff all be subject to disciplinary sanction. As noted in paragraph 54 we do not propose having a list of acceptable directors and individual staff members who are not eligible supervisors. Thus, all persons licensed as representatives to advise on corporate finance will be entitled to do sponsorship or IFA work under the supervision of an eligible supervisor, unless they have been declared to be an unacceptable person.

We propose disciplinary sanctions for sponsors and IFAs similar to those under the current GEM Listing Rules, but with some variations for individuals. As with our sanctions for issuers and directors, we propose a graduated hierarchy of shaming and disabling sanctions that provide the flexibility to ensure the sanction is appropriate to the circumstances. Our proposed sanctions are:

- Private reprimand;
- Public statement with criticism;
- Public censure;
- Declaration that an individual is an unacceptable person or cannot be an eligible supervisor for a specified period of time;
- Suspension of a firm from the list of acceptable sponsors or list of acceptable IFAs for a specified period of time;
- Declaration that an individual is an unacceptable person or cannot be an eligible supervisor; and
- Removal of a firm from the list of acceptable sponsors or list of acceptable IFAs.

Q.16 Do you agree with our proposals?

☒ *Yes*

☐ *No*

Please state reason(s) for your view.

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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*

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

☒ *Yes*

☐ *No*

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

☒ *Yes*

☐ *No*

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

☒ *Yes*

☐ *No*

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?