

2. COMMENTARY ON THE PROPOSED RULES UNDER CHAPTER 3A OF THE LISTING RULES AND INVITATION FOR COMMENTS

2.1 GENERAL (rules 3A.01 to 3A.02)

This section sets out the circumstances under which a new applicant is required to appoint a sponsor in its application for listing on the Exchange. It also sets out the relevant listing rules for financial advisers.

3A.01 Further to existing rule 3.01, proposed rule 3A.01 sets out the circumstances under which a new applicant is required to appoint a sponsor for the listing of securities on the Exchange. Whilst existing rule 3.02 only *recommends* that the issuer retains the services of its sponsor for at least one year following its listing, proposed rule 3A.01 now makes this mandatory. This 1-year period is defined as the “Fixed Period” (see proposed rule 3A.75).

This provision is also consistent with existing rule 19A.05(1) which requires a PRC issuer who is a new applicant to “...retain for at least one year...following its listing the services of its sponsor, or other financial adviser or professional firm which is acceptable to the Exchange...”. This aims to ensure that the directors of the listed issuer are properly guided to comply with the Listing Rules.

For information, the GEM Listing Rules also require an issuer to retain the services of a sponsor after its listing for a period covering at least the remainder of the financial year during which the listing occurs and the 2 financial years thereafter. However, the Exchange considers the timeframe imposed by GEM to be too stringent for issuers listed on the Main Board. This is because such issuers are required to meet the trading record under existing rule 8.05 whilst issuers who wish to seek a listing on GEM may be new ventures with no or an insufficient track record.

The Exchange invites comments on proposed rule 3A.01, in particular, the retention of the services of the sponsor over the Fixed Period and the duration of this period.

3A.02 The existing rules do not currently set out the eligibility criteria or responsibilities in relation to financial advisers. The proposed rules now require that all parties appointed pursuant to the Listing Rules to advise a listed issuer, its directors or shareholders on corporate finance and other matters involving the application and interpretation of the Listing Rules, must be subject to the provisions of proposed rules 3A.82 to 3A.97. These provisions relate to, among other things, the basic qualification and eligibility criteria for financial advisers and their responsibilities.

Although proposed Chapter 3A aims to lay down minimum guidelines and standards for financial advisers, the Exchange does not intend to impose such conditions on advisers that are *not* required to be appointed pursuant to the Listing Rules.

The Exchange invites comments on the proposed introduction of rules governing financial advisers.

2.2 SPONSORS (rules 3A.03 to 3A.81)

In order to achieve a minimum level of standard among sponsors to new applicants, the Exchange now proposes that all prospective sponsors must have been approved by the Exchange for such purposes and admitted to a list of sponsors maintained and updated by the Exchange from time to time. The list of sponsors will be posted on the Exchange's web site at <http://www.sehk.com.hk>.

The Exchange considers that the introduction of the list of sponsors would lead to the following advantages:

- (a) an upgrade of the quality of sponsors due to the need for prospective sponsors to:
 - (i) meet the eligibility criteria set out under proposed rules 3A.13 to 3A.25 of this chapter; and
 - (ii) undertake to discharge their duties and responsibilities as sponsors to the satisfaction of the Exchange in accordance with proposed rule 3A.07; and
- (b) the elimination of the need for sponsors to demonstrate whether they are able to satisfy the eligibility criteria for sponsors upon *each* occasion an application for listing is submitted on behalf of a new applicant.

However, with the adoption of this pre-registration system, sponsors now have an obligation to update the Exchange from time to time on any matters that may affect their continued inclusion on the list of sponsors. Although sponsors will face additional responsibility under the proposed system, the Exchange considers that the resulting benefit of a uniform and higher standard among sponsors will benefit all parties concerned.

The application procedure for admission to the list of sponsors is specified under proposed rules 3A.07 to 3A.11 and the basic qualification and eligibility criteria that must be satisfied for admission to the list of sponsors are set out in proposed rules 3A.14 to 3A.25.

The Exchange now invites comments on the introduction of the pre-registration requirement for sponsors.

2.2.1 Introduction (rules 3A.03 to 3A.06)

3A.03 This proposed rule explains the need for prospective sponsors to be admitted to the Exchange's list of sponsors and to satisfy the eligibility requirements set out under proposed rules 3A.14 to 3A.25. These include, among other things, being properly licensed by the Commission, meeting the minimum financial and manpower requirements and possessing relevant corporate finance experience (as defined in Note 1 to proposed rule 3A.08).

In order not to bar newly established firms from the opportunity to assume sponsorship activities, this rule permits such firms to act in the capacity of a co-sponsor in circumstances where they are unable to satisfy the requirements of proposed rule 3A.17 but are nevertheless able to satisfy all other provisions under proposed rules 3A.14 to 3A.25 in relation to the basic qualification and eligibility criteria for sponsors (please refer to section 2.2.3 below). However, only a sponsor with no such limitation in capacity may be retained over the Fixed Period (as defined in proposed rule 3A.75)

The Exchange invites comments on whether the requirements to act as co-sponsors are fair and reasonable.

3A.04 Once a sponsor has been admitted to the list of sponsors, it must comply with the provisions relating to the continuing obligations set out under proposed rules 3A.30 to 3A.39. Although the continuing eligibility of a sponsor will be reviewed on an annual basis in accordance with proposed rule 3A.37, the Exchange reserves the right to review a sponsor's continued admission to the list of sponsors at any time it considers necessary. In this connection, the Exchange would pay particular attention to a sponsor that is the subject of an investigation or has been, inter alia, publicly censured or sanctioned.

3A.05 This proposed rule allows the Exchange the discretion to reject a prospective sponsor admission to the list of sponsors and to impose additional criteria, as it thinks fit. The objective of this provision is to allow the Exchange a degree of flexibility in determining the suitability of a prospective sponsor in its application for admission onto the list of sponsors based on the particular circumstances of the case.

3A.06 The principles considered by the Exchange in assessing a sponsor's suitability to act in that capacity are set out under proposed rule 3A.06, including the preservation of the reputation and integrity of the Exchange.

The Exchange invites comments on proposed rules 3A.03 to 3A.06 and, in particular, the introduction of the list of sponsors to be maintained by the Exchange.

2.2.2 Application Procedure (rules 3A.07 to 3A.12)

The proposed section sets out the application procedure for admission to the list of sponsors together with the expected timing for the application process.

3A.07 Applications for admission to the list of sponsors must be accompanied by all relevant documents, a non-refundable application fee of HK\$30,000 and an undertaking to the Exchange to accept the responsibilities of a sponsor as outlined in the Listing Rules.

3A.08 Details of, inter alia, any public censure or disciplinary action against a prospective sponsor, its directors or members of staff must be disclosed in the application form for admission to the list of sponsors pursuant to this rule.

Notes to Proposed Rule 3A.08

Note 1. *The term “corporate finance experience” is defined in this note to mean:*

“...experience derived from providing advice on matters under the Listing Rules, the Takeover Code and Code on Share Repurchases”.

Note 2. *A prospective sponsor is also required to provide details of any disciplinary action taken against its Sponsor Group (as defined in Note 3 to this rule).*

Note 3. *The term “Sponsor Group” is defined in this note to mean:*

“...any company comprising the sponsor, its ultimate holding company and any of their subsidiaries”.

The Exchange invites comments on the definitions of “corporate finance experience” and “Sponsor Group” as set out in notes (1) and (3) of proposed rule 3A.08.

3A.09 The Exchange considers that any past public censorship of a prospective sponsor or its employees would cast doubt on their professional conduct and integrity. On this basis, the Exchange is likely to reject an application for admission to the list of sponsors if such parties had been so censured in the 5-year period prior to application. The Exchange considers that this timeframe would be sufficient to ensure the integrity of a prospective sponsor in its sponsorship activities.

The Exchange invites comments on proposed rule 3A.09 and, in particular, on the 5-year window period mentioned in this rule.

- 3A.10** During the Exchange’s assessment of the application, prospective sponsors may be invited for an interview. The decision to approve or reject an application for admission to the list of sponsors will be made by the Listing Committee or an appropriate body within the Exchange. Where an application is rejected by the Listing Committee or an appropriate body within the Exchange, the prospective sponsor may follow the rules for right of appeal under Chapter 2B of the Listing Rules.
- 3A.11** The Exchange reserves the discretion to admit a sponsor to the list of sponsors and to impose any other conditions, restrictions or other requirements as it thinks fit.
- 3A.12** The role of the Exchange has never been to recommend the services of sponsors or, for that matter, of financial advisers. With the proposed introduction of a list of sponsors, the Exchange considers it necessary to clarify its position that admission to the list of sponsors does not guarantee the quality of work or standard of performance of such sponsors.

The Exchange invites comments on proposed rules 3A.07 to 3A.12 in relation to, inter alia, the procedures for admission to the list of sponsors.

2.2.3 Basic Qualification and Eligibility Criteria (rules 3A.13 to 3A.25)

This section aims to set down the basic eligibility criteria for sponsors. These include the basic levels of experience, for both the firm and the individual, and resources prospective sponsors must meet, being an extension to note (4) of existing Appendix 9 to the Listing Rules on Model Code for Sponsors (the “Model Code”).

- 3A.14** This rule lays down the basic qualifications of a prospective sponsor and represents a codification of the existing practice of the Exchange. Pursuant to note (1) of this rule, all sponsors must be limited liability companies incorporated under the Companies Ordinance.

Currently, a sponsor must be registered as an investment adviser or securities dealer pursuant to the Securities Ordinance or must have been declared by the Commission to be an exempt dealer. However, proposed note (2) requires that a sponsor is to be “...*properly licensed by the Commission or is otherwise appropriately exempt from the licensing requirements*” to take into account any subsequent changes to the licensing requirements upon the eventual introduction of the Securities and Futures Composite Bill.

Proposed note (5) aims to ensure that sponsors comply with any new criteria and responsibilities introduced by the Exchange from time to time

The Exchange invites comments on the basic qualifications to be satisfied by prospective sponsors set out under proposed rule 3A.14.

3A.15 In the past, the Exchange has come across sponsors who, despite their registration under the Securities Ordinance, failed to properly discharge their duties to the satisfaction of the Exchange. This may have been due to, for example, inadequate corporate finance advisory experience of the sponsor and its employees. The corporate finance experience expected of a sponsor shall bear the same meaning as that defined in Note (1) to proposed rule 3A.08.

3A.16 Following from note (4) of the Model Code which states that “...a sponsor should satisfy himself that he has adequate resources to fulfil the role expected of a sponsor...”, proposed rule 3A.16 aims to lay down the minimum capital requirement a prospective sponsor must satisfy.

3A.16(1) Whilst a prospective sponsor must ensure that it has adequate resources to fulfil its role as a sponsor, the Exchange does not wish to, for example, unwittingly exclude a firm which only has a nominal paid-up share capital but boasts a substantial non-distributable reserve from acting as sponsor. In this connection, and in line with the GEM Listing Rules, it is proposed that a sponsor must, inter alia, have a total paid-up share capital and/or non-distributable reserves of not less than, say, HK\$10 million represented by unencumbered assets *and* a net tangible asset value after minority interests of not less than, say, HK\$10 million.

The Exchange invites comments on the HK\$10 million minimum capital threshold proposed under this rule.

3A.16(2) If a sponsor is unable to meet the capital requirement stipulated under proposed rule 3A.16(1), then the Exchange is prepared to accept an unconditional and irrevocable guarantee from a company within the Sponsor Group (as defined in note (3) to proposed rule 3A.08) or an authorized institution in respect of the prospective sponsor’s liabilities up to an aggregate amount of not less than HK\$10 million (being the capital requirement stipulated under proposed rule 3A.16(1)). Specifically, proposed rule 3A.16(2) caters for:

- (i) the smaller corporate finance firm which is unable to meet the financial requirements on its own but could obtain a guarantee from a member of its Sponsor Group; and
- (ii) sponsors that incur liabilities or losses during the ordinary conduct of their corporate finance business such that their net tangible asset value after minority interests falls below, in this case, the HK\$10 million threshold stipulated in proposed rule 3A.16(1).

The Exchange invites comments on the proposal to accept guarantees from a company within the Sponsor Group or an authorised institution where a prospective sponsor is unable to meet the capital requirement under proposed rule 3A.16(1).

Notes to proposed rule 3A.16

Note 1 The purpose of this note is to keep in line with the requirement of existing rule 8.06 which stipulates that the latest financial period of a new applicant reported on by the reporting accountants must not have ended more than six months before the date of its listing document.

Note 2 The Exchange is aware that there may be circumstances where no audited accounts have been prepared by the prospective sponsor, such as a newly established corporate finance firm. One of the reasons for the acceptance of un-audited accounts is that it is not the intention of the Exchange to prevent newly established firms from acting as co-sponsors (see proposed rule 3A.03 on the requirements for co-sponsors) but to encourage and promote healthy competition among market participants.

The Exchange invites comments on the notes to proposed rule 3A.16.

3A.17 This proposed rule imposes a timeframe within which sponsorship activities must have been undertaken by the prospective sponsor to ensure that it has the width and breadth of experience demanded of a sponsor. The proposed timeframes set out in this rule are consistent with the requirements under the GEM Listing Rules.

Specifically, to be admitted on the list of sponsors, proposed rule 3A.17 requires that a prospective sponsor must have acted as sponsor on at least 2 completed initial public offering transactions during the 5 year period before application or as co-sponsor on at least 3 completed initial public offering transactions over the 5 year period before application. It is considered that the latter proposed criteria should offer sufficient flexibility for sponsors who possess adequate sponsorship experience but have not acted in the capacity of a “full” sponsor.

The Exchange considers that the completion of at least one initial public offering transaction during the year before application would ensure that a prospective sponsor is familiar with recent market developments as well as the latest requirements of the Exchange.

Note (1): For the purposes of proposed rule 3A.17, the Exchange does not recognise sponsorship experience gained from re-domicile cases. This is because the Exchange considers that the nature of experience and level of responsibility acquired by a prospective sponsor from these activities are insufficient to equip it in handling the demands of an initial public offering transaction.

Note (2): Pursuant to the provisions of this note, the Exchange reserves the right to determine whether the experience gained from sponsorship activities will be recognised as relevant experience for the purposes of this rule. Typically, where the sponsorship activity undertaken does not involve a new applicant seeking a primary listing on the Exchange by means of an initial public offering transaction, the Exchange will consider the nature and structure of the relevant transaction in question in its assessment of the experience of the prospective sponsor.

The Exchange invites comments on proposed rule 3A.17 and, in particular, the level of experience required of a prospective sponsor.

3A.18 In the past, the Exchange has witnessed numerous instances where a sponsor did not have a sufficient number of staff to handle its workload. The minimum requirement of 2 full-time executive directors and 2 other full-time staff members stipulated under proposed rule 3A.18 aims to alleviate this potential problem so that a prospective sponsor will be able to properly discharge its duties to both its client and the Exchange. This is in line with the GEM Listing Rules.

The Exchange invites comments on the level of manpower stipulated under proposed rule 3A.18.

3A.19 Further to proposed rule 3A.03, this proposed rule aims to differentiate the role of a lead sponsor, being an entity that is able to fulfil *all* the eligibility criteria under proposed rules 3A.14 to 3A.25, and a co-sponsor (see proposed rule 3A.03). Under this rule, only the lead sponsor may be the sole channel of communication with the Exchange.

3A.20 Proposed rule 3A.20 aims to ensure that a sufficient number of staff of the sponsor firm is available to handle any one listing application at any one time so as to enable the sponsor firm to discharge its role and responsibilities in a satisfactory manner. The proposed rule also stipulates that a listing application should be handled by at least one Principal Supervisor (as defined in proposed rule 3A.21) and one Assistant Supervisor (as defined in proposed rule 3A.22) to ensure that the responsible staff have the pre-requisite experience to deal with the Exchange.

The Exchange invites comments on the provisions of proposed rules 3A.19 and 3A.20.

3A.21 Following from rule 3A.20, this rule defines the qualifications and experience required of Principal Supervisors. The Exchange considers that the pre-requisite for a Principal Supervisor to have completed 2 initial public offerings over the 5-year period prior to the date of declaration should adequately enable him to competently manage the application procedure of a listing application.

The Exchange invites comments on the level of experience required of a Principal Supervisor.

3A.22 The objective of proposed rule 3A.22 is to embrace those individuals who are relatively new to the field of corporate finance and are unable to satisfy the prerequisite to become a Principal Supervisor. It is proposed that Assistant Supervisors must have at least 3 years of relevant corporate finance experience, which the Exchange considers to be the minimum period required to understand the application of the Listing Rules. To ensure Assistant Supervisors are properly guided, these individuals must be closely supervised by the Principal Supervisors (see proposed rule **3A.24**)

The Exchange invites comments on the level of experience required of an Assistant Supervisor.

3A.23 (1) Further to proposed rules 3A.21 and 3A.22, each of the Principal Supervisors and Assistant Supervisors is required to complete a declaration to confirm the issues referred to in these proposed rules.

(2) Under this proposed subparagraph, flexibility is afforded those individuals who do not strictly fulfil the requirements to become a Principal Supervisor pursuant to proposed rule 3A.21 but nevertheless have over 5 years of proven experience of public offering transactions on the Exchange.

(3) In order to qualify as a Principal Supervisor or an Assistant Supervisor, the Exchange recognises the experience of the individual concerned. In other words, it is not necessary for a Principal or Assistant Supervisor to have been working for a prospective sponsor throughout all or any of the period to which his experience relates.

3A.24 This proposed rule provides that a sponsor must ensure its less experienced staff (Assistant Supervisors) are properly and closely supervised and managed by the more experienced staff (Principal Supervisors).

The Exchange invites comments on the provisions of proposed rules 3A.21 to 3A.24 in relation to Principal Advisors and Assistant Advisors.

3A.25 Proposed Chapter 3A strives to place increasing importance on the need for sponsors to have proper and appropriate internal controls to carry out sponsorship activities. Proposed rule 3A.25 aims to stress the importance of internal controls and clear reporting lines to ensure that individuals within the sponsor firm do not act beyond their respective level of authority.

The primary objective of this rule is to ensure that all information provided to the Exchange have been considered and reviewed by staff with the appropriate level of authority and expertise within the sponsor firm. Only on this basis will the Exchange be prepared to rely, in confidence, on the information provided in respect of a listing application. This is in line with business ethics widely adopted by the financial community.

The Exchange invites comments on proposed rule 3A.25.

2.2.4 Independence of Sponsors (rules 3A.26 to 3A.29)

Under existing guideline number (4) of the Model Code, sponsors must be “...*capable of giving the issuer impartial advice before agreeing to accept the role*”. In addition to elaborating on this requirement, the proposed rules under this section also codify the Exchange’s existing practice and views on the issue of independence. To stress the importance of impartiality of a sponsor and to minimize, if not eliminate, instances of conflicts of interests, this section aims to illustrate circumstances which may give rise to concerns on a sponsor’s independence.

To reflect the trend towards a disclosure-based market, the Exchange is now prepared to accept, subject to proposed rule 3A.27, situations where a sponsor or its Sponsor Group has an interest in the new applicant provided that these interests are clearly disclosed in the relevant listing document.

By encouraging transparency, investors are given the opportunity to judge for themselves whether a sponsor’s interest in a new applicant would affect their decision in investing in the new applicant. In addition, as the Exchange relies heavily on information provided by sponsors in arriving at its recommendation on whether to approve a listing application and investors, in turn, rely solely on information disclosed in a prospectus in arriving at their investment decision, the independence and integrity of a prospective sponsor are critical elements in the application procedure. The independence of a sponsor would therefore help to ensure that it is able to objectively form a true and fair view on, inter alia, the suitability of a new applicant.

3A.27 This proposed rule sets out circumstances that may give rise to concerns on a sponsor’s independence and codifies the Exchange’s current practice in this area.

- (1) The Exchange considers that the holding of an interest, directly or indirectly, of more than, say, 5 per cent in the new applicant or the control of the board of directors of the new applicant may give rise to concerns on a sponsor’s independence. The Exchange considers that a passive shareholding of up to 5 per cent by the sponsor in a new applicant should not, per se, prevent a sponsor from acting for such company. In addition, a sponsor’s nominal shareholding could even be regarded to demonstrate its confidence in the business and management of the new applicant.

The Exchange invites comments on the 5 per cent threshold stipulated in proposed rule 3A.27(1).

- (2) The Exchange is aware that sub-paragraph (1) to proposed rule 3A.27 only considers the shareholding interests of the sponsor in the new applicant. Proposed sub-paragraph (2) to rule 3A.27 considers the impact of the *value* of such interest on the sponsor or its Sponsor Group. Specifically, the Exchange is of the view that there may be a conflict of interests issue where the value of the shareholding interest referred to in proposed rule 3A.27(1) exceeds 15 per cent of the consolidated net tangible assets of the Sponsor Group.

The 15 per cent threshold is consistent with the Exchange's definition of a "major subsidiary" and represents a value which the Exchange considers to be "material" to a particular entity. For information purposes, a "major subsidiary" is defined in paragraph 17(2) of the Listing Agreement as "...representing 15 per cent or more of the consolidated net tangible assets or pre-tax trading profits of the group". Thus, a shareholding in a new applicant exceeding 15 per cent of the net tangible assets of the Sponsor Group would be considered to be material to the sponsor and its Sponsor Group.

The Exchange invites comments on proposed rule 3A.27(2), in particular, (a) the 15 per cent threshold in value of a sponsor's shareholding in a new applicant and (b) the use of a Sponsor Group's consolidated net tangible assets as the denominator for such threshold.

- (3) Instances where a sponsor is controlled by or is under the same control as a new applicant would also raise conflicts of interests concerns. The definition of "control" is ascribed the same meaning as under the Takeover Code from time to time.
- (4) The Exchange accepts the situation where the new applicant may be enjoying banking facilities granted to it by the Sponsor Group. Where these are granted on normal commercial terms and in the ordinary and usual course of business, such banking relationships would not normally bar the relevant sponsor from assuming sponsorship activities on behalf of its client.

However, in order to ensure that a new applicant does not place undue reliance on financial assistance granted by any particular Sponsor Group and to maintain impartiality, it is proposed that the value of financial assistance granted by such Sponsor Group and utilized by the new applicant should not exceed 50 per cent of the new applicant's aggregate banking facilities. This threshold had been previously endorsed by the Listing Committee.

The Exchange invites comments on the 50 per cent threshold stipulated in proposed rule 3A.27(4).

- (5) The Exchange has increasingly noticed instances where proceeds raised from initial public offerings are being applied to settle the new applicant's debts, particularly those debts that are due to the Sponsor Group. Although the Exchange does not dictate how a new applicant should use such proceeds, it is often encouraged that the monies raised should be used for the expansion and development of the new applicant's business.

In order to impose a guideline on this increasing trend and, in particular, where the proceeds are applied to settle the debts due to the Sponsor Group, it is proposed that not more than 50 per cent of the proceeds should be utilized in this connection. This threshold, which is in line with proposed rule 3A.27(4), had been previously endorsed by the Listing Committee. Finally, so as to eliminate any conflict of interests between a sponsor and a prospective client, a new applicant is encouraged to appoint another sponsor to whom the new applicant does not owe debt.

The Exchange invites comments on the 50 per cent threshold stipulated in proposed rule 3A.27(5).

- (6) The Exchange will consider on a case-by-case basis the question of independence where a director or an employee of the sponsor has an interest in any class of shares, debt or loan capital of, or business or other interests in, a new applicant. No specific threshold is stipulated in the proposed rule as the Exchange considers there may be unlimited possibilities. Therefore, early consultation with the Exchange is encouraged as per proposed rule 3A.26.

The Exchange invites comments on proposed rule 3A.27(6).

- 3A.28** Whilst the Exchange is fully aware that sponsors and their employees must observe the highest level of professional conduct and confidentiality when dealing with client affairs, there is no assurance that information is not inadvertently made known to other divisions within a Sponsor Group. Proposed rule 3A.28 serves to clarify the Exchange's position that a sponsor may not rely solely on the presence of a Chinese Wall to justify its position of independence and impartiality.

In this connection, a prospective sponsor may be required to demonstrate to the satisfaction of the Exchange how it safeguards its independence and impartiality.

The Exchange invites comments on the provisions of proposed rule 3A.28.

- 3A.29** It is proposed that all interests of the sponsor and its employees in the relevant new applicant must be disclosed in the listing document and all subsequent documents released by the issuer during the Fixed Period. The Exchange considers that this proposed rule will allow investors to personally judge whether they consider there to be a conflict of interests issue.

The Exchange invites comments on the proposed rule 3A.29.

2.2.5 Continuing Requirements (rules 3A.30 to 3A.39)

This section summarizes the continuing obligations of a sponsor and those of the Principal and Assistant Supervisors.

- 3A.31** This rule provides that all Principal and Assistant Supervisors are required to comply with the provisions of proposed rules 3A.20 and 3A.24.

- 3A.32** This proposed rule serves to provide a guideline on the maintenance of the capital requirement set out under proposed rule 3A.16. The provisions set out below are in line with the requirements under the GEM Listing Rules.

- (1) The proposed rule stipulates that a sponsor must not accept new mandates in the event the sponsor's capital requirements fall below the HK\$10 million threshold of proposed rule 3A.16(1). In line with proposed rule 3A.16(2), the Exchange may also be prepared to accept an unconditional and irrevocable guarantee from a company within the Sponsor Group.

The objective of proposed rule 3A.32(1) is to ensure that a sponsor maintains the financial resources at the level at which it was first admitted to the list of sponsors. In other words, the Exchange aims to ensure that a sponsor:

- (a) was not involved in any creative accounting at the time of its application to the sponsors' list; and
 - (b) is able to fulfil its obligations in sponsorship activities and any other corporate finance matters it has already accepted to undertake.
- (2) It is possible that a sponsor may incur liabilities or losses during the conduct of its corporate finance business. Proposed rule 3A.32(2) serves to allow the sponsor a period of 30 days in which to restore the HK\$10 million threshold. However, under no circumstances should a sponsor's net tangible asset value after minority interest fall below HK\$5 million.

The Exchange invites comments on proposed rule 3A.32, in particular, the requirement that a sponsor's net tangible asset value after minority interest must be maintained at, at least, HK\$5 million at all times.

3A.33 This rule sets out certain events that must be notified to the Exchange upon their immediate occurrence and the resulting proposed course of action by the Exchange. These events include:

- i) the sponsor being no longer able to satisfy the eligibility criteria set out in this chapter, including the minimum number of staff required under proposed rule 3A.18 and any criteria or conditions imposed by the Exchange from time to time;
- ii) changes to any information provided by the sponsor to the Exchange in its application for admission to the list of sponsors, including where the sponsor, its Principal or Assistant Supervisors cease to be registered or have been charged with any indictable offence or censured or fined; and
- iii) the dismissal or resignation of any Principal Supervisor.

The Exchange considers that immediate notification to the Exchange is essential as any occurrence of the above events may affect the very eligibility of a firm or its employees to act as sponsors to a new applicant.

3A.34 Although a sponsor is expected to notify any changes concerning its Principal or Assistant Supervisors pursuant to proposed rule 3A.33, the Exchange considers that the Principal or Assistant Supervisor himself must have an obligation to notify the Exchange on any changes to his particulars previously provided to the Exchange.

3A.35 Notifications to the Exchange referred to under proposed rules 3A.33 and 3A.34 should be addressed to the Executive Director - Listing by fax and letter (or any other means as approved by the Exchange from time to time).

The Exchange invites comments on proposed rules 3A.33 to 3A.35 in relation to, inter alia, the occurrence of events that should be brought to the attention of the Exchange.

3A.36 This rule sets out the circumstances under which the Exchange reserves the right to remove a sponsor from the list of sponsors and, in particular, where the Exchange considers that the sponsor has failed to discharge its responsibilities and obligations under the Listing Rules. The events listed in proposed rule 3A.36 illustrate the seriousness the Exchange places on the continuing eligibility of a sponsor on the list of sponsors.

The Exchange invites comments on the list of events set out under proposed rule 3A.36 that may lead the Exchange to remove a sponsor from the list of sponsors and/or to take any other disciplinary action against a sponsor as it considers appropriate.

3A.37 The Exchange shall conduct annual reviews, upon payment of a review fee of HK\$10,000, of the sponsor's continued inclusion on the list of sponsors in accordance with the timetable set out in this proposed rule. The annual review requires a sponsor to confirm that it continues to satisfy the provisions under proposed rules 3A.14 to 3A.25 and to provide relevant supporting documentation. As with a sponsor's original application for admission, its continued inclusion on the list of sponsors will be considered by the Listing Committee or an appropriate body within the Exchange.

3A.38 The Exchange reserves a discretion to retain a sponsor on the list of sponsors subject to any conditions, restrictions or other requirements imposed by the Exchange from time to time and as it thinks fit. Once again, the Exchange recognises the particular circumstances of each case and shall consider the merits of each sponsor accordingly.

3A.39 Proposed rule 3A.39 stipulates that any decision by the Exchange to remove a sponsor from the list of sponsors will be notified to the sponsor in writing. Any sponsors aggrieved with the decision may make an appeal in accordance with the procedures set out in Chapter 2B.

The Exchange invites comments on the provisions of proposed rules 3A.33 to 3A.39 on the continuing obligations of sponsors.

2.2.6 Co-sponsorships and Additional Sponsors (rules 3A.40 to 3A.45)

Over the past couple of years, the Exchange has witnessed an increasing number of listing applications that had been co-sponsored by firms without sponsorship experience in the past. These firms are therefore unlikely to be familiar with the Exchange's requirements and practices specific to the review and process of an initial public offering transaction. This section sets out the roles and responsibilities of a co-sponsor and/or additional sponsor.

3A.40 Where more than one sponsor is appointed by a new listing applicant, only one sponsor should be designated as the point of contact with the Exchange. This is to ensure consistency and to avoid the need for the Exchange to deal with various parties on the same aspect. Further, it is the Exchange's intention to ensure that sponsors to a listing application is properly guided by the more experienced sponsor in order to maintain a minimum level of standard among sponsors and to meet the expectations of the Exchange. In this regard, the designated sponsor must fulfill the requirements of a lead sponsor as referred to in proposed rule 3A.19.

3A.41 In order to demonstrate that each sponsor has satisfied itself on the accuracy and completeness of all information provided to the Exchange, proposed rule 3A.41 codifies the Exchange's current practice of requiring all information submitted for its review to be signed by *each* of the sponsors to a listing application. This rule also strives to ensure that each of the sponsors to a listing application does not place undue reliance on the work performed by the others.

3A.42 To further emphasize the importance of not placing undue reliance on the work performed by other sponsors, proposed rule 3A.42 requires that each of the sponsors (whether as a sponsor or a co-sponsor) to a new applicant shall be *jointly and severally responsible* for the accuracy and completeness of all information provided to the Exchange in respect of the relevant listing application. The joint and several responsibility aims to ensure that each of the sponsors discharges its role and responsibilities in a manner satisfactory to the Exchange. Otherwise, **each** of the sponsors concerned may be subject to the sanctions set out under proposed rule 3A.99.

3A.43 Where a co-sponsor to a listing application is apparently the main provider of information to the Exchange, the Exchange may question the lead sponsor concerned in a meeting to determine whether it is, in fact, assuming the role of lead sponsor in name only. The result of the meeting will be taken into consideration in the review by the Exchange of a sponsor's continued inclusion on the list of sponsors in accordance with proposed rule 3A.37.

In the past, the Exchange has encountered instances whereby the lead sponsor had not been able to provide information requested and had to instruct the co-sponsor to address issues raised by the Exchange. Given that the lead sponsor must be the sole channel of communication with the Exchange pursuant to proposed rule 3A.19, proposed rule 3A.43 also serves to ensure that the more experienced lead sponsor to a listing application can be held fully accountable and responsible for all information, whether verbal or written, provided to the Exchange.

3A.44 The Exchange has noted an increasing number of instances whereby an additional sponsor had been introduced during the processing of a listing application. In order to ensure that the additional sponsor is fully aware of, and can be held fully accountable for, all information provided to the Exchange in respect of a listing application, proposed rule 3A.44 requires the submission of a new advance booking form, together with a new initial listing fee in accordance with Appendix 8 to the Listing Rules, where there is an addition of a new sponsor during the processing of a listing application. The provisions of proposed rule 3A.44 mirrors those set out under existing rule 9.03(1).

3A.45 Proposed rule 3A.45 stipulates that, where there is more than one sponsor to a listing application, only one sponsor is required to be retained over the Fixed Period (as defined in proposed rule 3A.75) for the purposes of proposed rule 3A.77. The retained sponsor must fulfill the requirements of proposed rules 3A.14 to 3A.25 in relation to the basic qualification and eligibility criteria of sponsors in order to ensure that the new issuer's directors are properly guided.

Where a financial adviser is appointed by an issuer during the Fixed Period, it must be able to fulfil the requirements set out under proposed rules 3A.82 to 3A.97 in relation to "Financial Advisers".

The Exchange now invites comments on the provisions of proposed rules 3A.40 to 3A.45 on "Co-sponsorships and Additional Sponsors".

2.2.7 Responsibilities of Sponsors (rules 3A.46 to 3A.74)

Proposed rules 3A.46 to 3A.74 refer to the responsibilities of a sponsor to each of the Exchange, the co-sponsors and professional advisers to a listing application and to the directors of the new applicant. The provisions of this section could be regarded as extensions of the provisions set out under the Model Code.

However, attention must be drawn to the fact that the proposed rules now place a particular onus on sponsors to make their own due and careful enquiries and not to place undue reliance on information provided by other parties to a listing application. This requirement represents a natural progression from the existing guideline 5 of the Model Code which requires that a sponsor:

“..should be closely involved in the preparation of the listing document and in ensuring that all material statements therein have been verified and that it complies with the Exchange Listing Rules and all relevant legislation”.

As a point for illustration, although a new applicant’s profit and cashflow forecasts are prepared by the reporting accountants, a sponsor is expected to carry out its own review on the fairness and reasonableness of the assumptions and bases on which such forecasts were prepared. The Exchange also expects a sponsor to question the reporting accountants on a new applicant’s audited accounts if it considers there to be issues that would have potential implications on the listing application under the Listing Rules.

Responsibilities owed to the Exchange (rules 3A.47 to 3A.66)

This section sets out the basic responsibilities owed by a sponsor to the Exchange and emphasizes the importance the Exchange places on a sponsor’s need to, inter alia, form an opinion on the suitability of a new applicant for listing after due and careful enquiry (see section on “Due and Careful Enquiry” below).

General Provisions

3A.47 This proposed rule requires a sponsor to designate 2 of its executive directors to be answerable to the Exchange concerning all matters relevant to the sponsor. The Exchange considers that the appointment of executive directors for this purpose to be essential as these parties are expected to have full access to information concerning their firm, its Sponsor Group and their employees. The designated directors are expected to promptly and comprehensively address any queries raised by the Exchange.

3A.48 Proposed rule 3A.48 sets out the responsibilities of a sponsor in the conduct and logistics of an initial public offering which involves the offer for subscription or an offer for sale to the public (the “public offer”). These responsibilities include, inter alia, the overall management of the public offer and ensuring that the public offer is conducted in a fair, timely and orderly manner.

The Exchange considers that sponsors are responsible for conducting and managing the entire public offer process as they have a duty to ensure that appropriate arrangements are in place for potential investors to subscribe for shares in a public offer in an efficient and orderly manner. To meet this objective, sponsors are required to have sufficient arrangements and resources in place in the discharge of their responsibilities toward, inter alia, the investing public.

3A.49 In discharging its obligations under proposed rule 3A.48, a sponsor is expected to have regard to the matters set out in proposed rule 3A.49 which stress the importance of having sufficient resources in place to ensure an orderly market. These include ensuring that there are sufficient prospectuses and application forms for securities offered for distribution to the public and that the distribution and collection of prospectuses and application forms, whether successful or unsuccessful, are conducted in a timely and orderly fashion (subparagraphs **(1)** and **(3)**).

To emphasize the importance the Exchange attaches to the provisions of this proposed rule:

- (a) under subparagraph **(2)**, a sponsor is expected to seek the services of other professionals or advisers if there arises certain responsibilities in relation to the public offer better handled by such parties. However, the provision does not in any way derogate a sponsor's obligation to act as the overall manager of the public offer; and
- (b) under subparagraph **(4)**, a sponsor is expected to draw up contingency plans in the event that disorder arises during the public offer period and before the trading of securities commences.
- (c) under subparagraph **(5)**, where balloting is required to determine the successful applications under a public offer, appropriate arrangements must be put in place to ensure that balloting would be conducted fairly and independently of the new applicant and parties associated with it.

The Exchange now invites comments on proposed rules 3A.48 and 3A.49 in relation to, inter alia, the responsibilities of a sponsor in ensuring an orderly market during the offer period. For information purposes, provisions similar to those under proposed rules 3A.48 and 3A.49 are present in the Commission's Corporate Finance Adviser Code of Conduct.

3A.51 Proposed rule 3A.51 codifies note 7 of the Model Code in that it requires a sponsor to ensure matters raised by the Exchange are resolved to the satisfaction of the Exchange and, pursuant to proposed rule **3A.54**, in a timely manner.

3A.52 Proposed rule 3A.52 repeats the provisions of note 8 of the Model Code in that it requires a sponsor to accompany a new applicant at any meetings with the Exchange. To reflect the trend to be adopted by the Exchange, this proposed rule further stipulates that a sponsor is required to address questions in relation to a listing application if, and when, required by the Listing Committee or an appropriate body within the Exchange.

The Exchange invites comments on the provisions under proposed rules 3A.51, 3A.52 and 3A.54.

Due and careful enquiry

The provisions under Chapter 3A on a sponsor's obligation to discharge its responsibilities with due care and skill can be regarded as an extension of the requirements of the Model Code. The importance attached by the Exchange to this issue can be demonstrated by the following rules which are drafted to emphasize, inter alia, the need for a sponsor to make due and careful enquiries and not to place unsubstantiated reliance on work performed by other professional parties to a listing application:

3A.50 A sponsor is expected to know its client so that it will be able to conclude, having made due and careful enquiries, whether a new applicant is suitable to be listed on the Exchange. This provision is derived from guideline (1) of the Model Code.

3A.53 A sponsor must be closely involved in the preparation of the listing document and ensure that all material statements therein have been verified and that it complies with the Listing Rules and all relevant legislation. This provision is extracted from guideline (5) of the Model Code.

3A.55 A sponsor must obtain written confirmation from the new applicant that financial information published in the listing document had been properly extracted from the accounting records of the new applicant. This proposed rule aims to ensure that such financial information had not been carelessly extracted for inclusion in the relevant listing document.

3A.56 A sponsor has the duty to ensure that all material information is included in an advanced proof of the listing document which is submitted to the Exchange at the time of lodging the advance booking form.

The Exchange considers that this can be comfortably achieved if a sponsor had been diligent in its verification work. Otherwise, in accordance with the provisions of this proposed rule, the Exchange reserves the right to return the advance booking form, together with the accompanying initial listing fee, to the sponsor (see also the commentary on proposed rule 3A.56 under "Other Significant Provisions" section below).

3A.60 A sponsor must verify all documents, whether prepared by itself or by other professional advisers to a listing application, and the relevant listing document prior to their submission to the Exchange. Only upon the completion of this verification process will the sponsor be able to complete the declarations referred to in proposed rule 3A.64. In other words, a sponsor is ultimately responsible for all information relating to a new applicant upon which the Exchange relies in its processing of the listing application.

3A.61 A sponsor is to submit a confirmation of compliance, to be signed by the respective heads of its compliance and corporate finance departments, upon completion of its in-house due diligence questionnaire on the new applicant.

It is understood that all sponsors make use of in-house checklists and questionnaires. However, the purpose of the confirmation of compliance is to demonstrate to the Exchange that both heads of the compliance and corporate finance departments are fully aware of the status and progress of a listing application and can be held accountable for the quality of work undertaken by their staff.

3A.62 A sponsor, in order to be able to conclude whether a new applicant is suitable for listing, must have first satisfied itself that the new applicant has proper accounting and management information systems, and effective internal control procedures. Apart from conducting its own investigations to achieve this objective, a sponsor must obtain written confirmation from the new applicant that the directors have established procedures which provide a reasonable basis for them to make proper judgements as to the financial position and prospects of the new applicant and its group. A sponsor must also be satisfied that this confirmation has been given after due and careful enquiry by the new applicant.

The Exchange considers that the requirements and objectives referred to under, inter alia, proposed rules 3A.60 and 3A.61 can only be achieved upon a sponsor's fulfilment of this rule.

The Exchange invites comments on the above provisions relating to a sponsor's need to carry out due and careful enquiry on the new applicant and not to place undue reliance on work performed by other professional advisers to a listing application.

Other Significant Provisions

3A.56 In the opinion of the Exchange, if the draft listing document is not in a sufficiently advanced form to render a meaningful review, the Exchange reserves the right to return all documents, including the advance booking form and the initial listing fee, to the sponsor. This proposed rule makes a cross-reference to existing Rule 9.03(3) of the Listing Rules which requires the sponsor to re-submit a new advance booking form, together with the advanced proof of the prospectus, in the event the said documents had been returned to the sponsor in the manner described hereunder.

3A.57 The timetable of a listing application may be delayed if the Exchange considers that material changes had been made to the advanced proof of the listing document without its consent. If the timetable is delayed by more than 6 months from the date of the advance booking form, a new form accompanied by the initial listing fee will need to be submitted in accordance with the provisions of Chapter 9 of the Listing Rules.

The Exchange invites comments on the circumstances under which a sponsor may be required, under proposed rules 3A.56 and 3A.57, to re-submit an advance booking form and initial listing fee.

Unauthorized publication or leakage of material

The following rules represent a codification of the Exchange's existing practice and have been introduced to discourage any unauthorized publication or leakage of material and to uphold the integrity and professionalism expected of sponsors. The Exchange further considers that the provisions will:

- (a) help to create a fair and orderly market for all new applicants wishing to obtain a listing on the Exchange; and
- (b) prevent a sponsor or the media from imposing undue pressure or prejudice on the timing or outcome of the listing application at the hearing by the Listing Committee or by an appropriate body within the Exchange.

3A.58 This proposed rule stipulates that a new applicant's listing timetable may be delayed by up to a month depending on the degree and sensitiveness of the unauthorized publication or leakage of publicity material.

3A.59 Proposed rule 3A.59 provides that a sponsor must ensure all privileged information is kept confidential and refrain from personal account dealings when in possession of such information. Although it is expected that a sponsor must be fit and proper to carry out its/his duties, the Sponsor Group is expected to ensure that adequate controls are in place to safeguard, inter alia, any disclosure of privileged information.

The Exchange invites comments on the provisions of proposed rules 3A.58 and 3A.59.

Profit Forecasts and Estimates

3A.63 Proposed rule 3A.63 codifies an existing practice of the Exchange in that, where a profit forecast or estimate has not been prepared for inclusion in the listing document, each of the sponsors and underwriters to a new applicant are required to undertake to the Exchange that brokers affiliated with it will not include earnings estimates in their research reports.

The Exchange invites comments on the requirement to produce an undertaking in the event a profit forecast or estimate has not been prepared for inclusion in the listing document.

Documentation to the Exchange

3A.64 This proposed rule summarizes the documents which are required to be provided to the Exchange at the time of submission of the advance booking form and prior to the issue of the listing document.

3A.65 Proposed rule 3A.65 requires that working papers must be kept for a period of 6 years and be made available to the Exchange upon request.

3A.66 Any changes to the information provided in proposed rule 3A.64 are required to be notified to the Exchange in the first instance.

The Exchange now invites comments on the provisions relating to proposed rules 3A.64 to 3A.66.

2.2.8 Responsibilities between and among Co-sponsors (rules 3A.67 to 3A.69)

With an increasing number of firms assuming the role of co-sponsors, the Exchange requires a co-sponsor to actively participate in sponsorship activities in order to attain suitable experience for sole sponsorship work in future. Once again, the proposed rules emphasize the requirement for due and careful enquiry and the joint and several responsibility of all sponsors concerned.

The Exchange now invites comments on the provisions of proposed rules 3A.67 to 3A.69.

2.2.9 Responsibilities between Sponsors and other Professional Advisers (rule 3A.70)

3A.70 In the past, the Exchange encountered cases where a sponsor had placed unsubstantiated reliance on information provided by other professional advisers such as, but not limited to, reporting accountants, legal advisers and valuers. Under proposed rule 3A.70, a sponsor may be required to demonstrate to the Exchange how it has taken all reasonable steps to ensure that all information provided by such professional parties is accurate and complete. Further, whilst it is acknowledged that these parties have their own sets of professional standards and codes of conduct, this proposed rule aims to ensure that a sponsor does not place unsubstantiated reliance on the work of the other professional advisers.

Moreover, proposed rule 3A.70 adheres to the rationale behind the provisions of existing rules 3.03 and 3.04 which require a sponsor to deal with the Exchange “..on all matters arising in connection with the application” and to be satisfied that “...based on all available information, that the issuer is suitable to be listed...”.

The Exchange now invites comments on the provisions of proposed rule 3A.70.

2.2.10 Responsibilities between Sponsors and Directors of a New Applicant (rules 3A.71 to 3A.74)

This section was prepared with consideration to guidelines 2, 3 and 11 of the Model Code. In summary, a sponsor is expected to properly guide and advise directors of a new applicant on their responsibilities as directors of listed issuers and to ensure that they are able to honour their obligations to both the shareholders and creditors of the issuer.

The Exchange now invites comments on the provisions of proposed rules 3A.71 to 3A.74.

2.2.11 One-Year Continuing Sponsorship (rules 3A.75 to 3A.79)

The retention of the services of a sponsor over the Fixed Period (as defined in proposed rule 3A.75) is proposed to become mandatory. The objective is to ensure that directors are properly guided and advised on their fiduciary duties and obligations as directors of a listed issuer. The Exchange considers that the retention of the sponsor over the Fixed Period would ensure continuity of service of the relevant sponsor.

All financial advisers appointed by the issuer during the Fixed Period, subject to the provisions of proposed rules 3A.75 and 3A.77, must fulfil the relevant provisions of proposed rules 3A.82 to 3A.94.

3A.77 Proposed rule 3A.77 specifies that at least one Principal Supervisor and one Assistant Supervisor from the sponsor are to be involved in giving on-going corporate finance advice to the issuer over the Fixed Period. The responsibilities set out in this rule aim to ensure that the retained sponsor is actively involved in guiding and advising the issuer and its directors over the Fixed Period.

Responsibilities of the retained sponsor include:

- (1) To guide the listed issuer in the application and interpretation of the Listing Rules.

The Exchange considers that mere knowledge of the Listing Rules does not equate to the proper usage of such rules. A listed issuer and its directors will only gain a thorough understanding of the Listing Rules by observing their application in the daily activities of the listed issuer.

- (2) To have on-going communication with the listed issuer in the form of formal meetings.

- (3) To accompany the listed issuer at meetings with the Exchange.

This provision is extracted from guideline (8) of the Model Code. It aims to maximize the effectiveness of meetings between the listed issuer and the Exchange where, in particular, the directors of the listed issuer are perhaps still unfamiliar with the requirements and application of the Listing Rules.

- (4) To review the operating performance and financial condition of the listed issuer against the business objectives as disclosed in its listed document.

This provision originates from the Exchange's practice in ensuring, among other things, that an issuer is able to at least sustain its operating performance upon its listing on the Exchange. The Exchange also expects a sponsor ensure that its client adheres to the business objectives, future plans and application of proceeds as disclosed in its listing document. In other words, the provision aims to ensure that there are no material or adverse changes to the condition of an issuer as disclosed in its listing document upon which investors had based their investment decisions.

- (5) To monitor whether the profit forecast or estimate as disclosed in its listing document will be met by the listed issuer.

This provision codifies the Exchange's current practice of requiring a listed issuer to publish a press announcement if it fails to meet its profit forecast or estimate. As the period for which the profit forecast or estimate was prepared will end on a date within the Fixed Period, the Exchange considers that a sponsor should therefore bear the responsibility of ensuring that an issuer is able to comply with this requirement.

- (6) To ensure that all undertakings provided by the listed issuer, its directors and/or controlling shareholders and their beneficial owners at the time of listing will be honoured by the relevant parties. The various undertakings commonly provided by these parties include, inter alia:

- (a) an undertaking from the controlling shareholder(s) and their beneficial owners on the non-disposal of shares in the listed issuer pursuant to existing rule 10.07(1);
- (b) an undertaking from the controlling shareholder(s) and their beneficial owners on the pledging of shares in the listed issuer pursuant to note (3) to existing rule 10.07; and
- (c) an undertaking from the controlling shareholder(s) and the directors to indemnify the listed issuer against, inter alia, any potential liabilities arising from taxation or estate duties falling on any member of the listed group prior to its listing.

The need to provide the undertakings reflect the importance the Exchange places on the subject issues. In this connection, a sponsor is expected to ensure that the relevant parties abide by the terms of their respective undertakings.

- (7) To review all information, including announcements, circulars and financial reports of a listed issuer, provided to the Exchange prior to submission.

The objective of this provision is to ensure that all information provided to the Exchange is true, complete and accurate. The Exchange expects a sponsor to be actively engaged in the development and needs of its client in order to ensure that it is properly guided during its new status as a listed issuer.

- (8) To deal with the Exchange in respect of all matters relating to, and transactions proposed to be undertaken by, the listed issuer.

From past experience, the Exchange has encountered numerous occasions where a newly listed issuer is unfamiliar with the provisions of the Listing Rules in relation to, among other things, fund-raising exercises (Chapter 7) and Notifiable Transactions (Chapter 14). In this regard, a sponsor is required to be actively involved in guiding a listed issuer on these transactions in order to ensure it will be able to independently handle such matters upon the termination of the Fixed Period.

- (9) To brief all new appointees to the board of directors on their responsibilities and duties as directors of a listed issuer.

This provision is necessary to ensure all new directors are familiar with the additional obligations and responsibilities that come with being directors of a listed issuer. The Exchange considers that it is essential for sponsors to lay a solid foundation for the new directors in anticipation and preparation for the time when a sponsor is no longer required to closely guide the listed issuer on its responsibilities.

3A.78 Although it is acknowledged that it is the director's responsibility to notify the Exchange of any changes to his Declaration and Undertaking with Regard to Directors (as set out Appendix 5), proposed rule 3A.78 requires the retained sponsor to immediately notify the Exchange if it becomes aware of any such changes during the Fixed Period. This provision originated from guideline (11) of the Model Code.

The importance of this provision is illustrated by requiring the retained sponsor to share the responsibility of notifying the Exchange on any changes to a director's Form B.

3A.79 In accordance with proposed rule 3A.65, a sponsor must also retain all documentation pertaining to the work performed during the Fixed Period for a minimum period of 6 years.

The 6-year period stipulated in this provision is consistent with that of proposed rule 3A.65, which requires a sponsor's work on the listing application, together with records of any book building or placing exercises, be kept for a minimum period of 6 years. This provision is necessary in the event that the Exchange or any regulatory or other body is required to investigate the books and records of a sponsor relating to a listed issuer.

The Exchange invites comments on the provisions of proposed rules 3A.75 to 3A.79 and, in particular, the obligations of a sponsor over the Fixed Period referred to under proposed rules 3A.77 and 3A.78.

2.2.12 Termination of a Sponsor's Role (rules 3A.80 to 3A.81)

The proposed provisions under this section sets out the procedures involved upon the termination of a sponsor's role and are extracted from guidelines (9) and (10) of the Model Code. The rationale behind each proposed rule relating to the termination of a sponsor's role is explained below:

3A.80 This rule is a duplication of existing guideline (9) of the Model Code, namely, that a sponsor may only terminate its role as sponsor in exceptional circumstances and only after first notifying the Exchange of the reasons therefor.

To ensure continuity and consistency of service and obligations of a sponsor, the Exchange does not encourage the termination by a sponsor of its role unless the sponsor can justify such decision. In particular, a sponsor is expected to notify the Exchange if it harbours doubts or concerns on, inter alia, the suitability for listing of the new applicant or the integrity of its directors. A sponsor is also expected to draw the Exchange's attention to any other issues it considers would affect the outcome of the listing application.

3A.81 Proposed rule 3A.81 is extracted from existing guideline (10) of the Model Code and deals with the termination of a sponsor's role by the new applicant. The provision requires the subject sponsor to notify the Exchange of such termination and the reasons thereof, if known. In addition, the following sub-paragraphs to the proposed rule aim to clarify the position of the Exchange in view of the other relevant provisions, both existing and proposed, of the Listing Rules:

- (1) In accordance with Chapter 9 of the Listing Rules, the new sponsor in a listing application is required to re-submit the advance booking form together with a new initial listing fee. This provision is to ensure that the new sponsor does not place unsubstantiated reliance on the work performed by the previous sponsor and is able to satisfy itself, without qualification and after due and careful enquiry, that a new applicant is suitable for listing. By undertaking its own due diligence work, the new sponsor will be held fully accountable for any information provided to the Exchange in respect of a listing application.

- (2) This subparagraph provides that, where the termination is made during the Fixed Period, a sponsor or financial adviser must be appointed as soon as practicable to replace the role of the resigned or disposed sponsor. The purpose of this provision is to ensure that a newly listed issuer will be able to enjoy the continued services of a sponsor or financial adviser over the Fixed Period.

The Exchange now invites comments on proposed rules 3A.80 to 3A.81 in relation to the termination of a sponsor's role and the arrangements relating thereto.

2.3 FINANCIAL ADVISERS (rules 3A.82 to 3A.97)

This section of chapter 3A deals with financial advisers, which term includes independent financial advisers (“IFAs”), appointed pursuant to the Listing Rules. Whilst *all* financial advisers are expected to comply with the provisions of proposed rules 3A.83 to 3A.94, proposed rules 3A.95 to 3A.97 refer specifically to the appointment of financial advisers as IFAs. References made to financial advisers shall be construed to include IFAs unless otherwise stated.

The objective of this section is to ensure that financial advisers uphold the highest level of conduct and standard in its obligations toward the listed issuer and the Exchange. Currently, there are no such provisions in the Listing Rules. In order that financial advisers recognise the importance of their obligations, the proposed rules now allow the Exchange to impose sanctions against financial advisers for, among other things, breaches of their responsibilities under the Listing Rules.

However, it should be noted that the Exchange reserves an absolute discretion to waive any criteria, impose any other conditions and to reject the appointment of a financial adviser pursuant to proposed rule **3A.83**. In cases of doubt, a prospective financial adviser is encouraged to consult the Exchange at the earliest opportunity.

2.3.1 Basic Qualification and Eligibility Criteria (rules 3A.82 to 3A.89)

The basic eligibility criteria for financial advisers are set out in proposed rules 3A.84 to 3A.89 and substantially mirror the eligibility criteria for sponsors. This is because the Exchange considers that the role and responsibilities expected of a financial adviser are very similar to those expected of a sponsor and both parties often represent the same parties or entities. The rationale behind the introduction of the rules in this section is explained below:

3A.84 A financial adviser, whether a corporation or an individual, must be acceptable to the Exchange. This provision is introduced to preclude financial advisers who do not possess the relevant experience or expertise to properly discharge their duties and responsibilities.

- 3A.85** Financial advisers that are corporations are expected, like sponsors, to be limited liability companies and be properly licensed by the Commission. However, whilst sponsors need to satisfy the capital requirement provisions under proposed rule 3A.16 (as extended by proposed rule 3A.32), subparagraph (3) of this rule requires a financial adviser to ensure that it has sufficient financial resources *to meet all its underwriting obligations on hand*. This provision strives to ensure that a financial adviser does not blindly accept underwriting mandates without first assessing its financial position and ability to undertake such commitments.
- 3A.86** Financial advisers, being individuals, must also be properly licensed by the Commission or be exempt from this requirement. This provision is in line with the registration requirements of Principal and Assistant Supervisors pursuant to proposed rules 3A.21 and 3A.22 respectively.
- 3A.87** As with sponsors, a financial adviser is also required to be capable of providing impartial advice before agreeing to accept its role. In particular, the Exchange would have concerns on the independence of a financial adviser where it would benefit from, or has an interest in, a transaction contemplated by a listed issuer. A financial adviser is expected to be objective in providing advice to a listed issuer and its directors in order to be able to conclude whether the terms of a proposed transaction are fair and reasonable and in the best interests of the listed issuer and its shareholders.
- 3A.88** The provision of this rule mirrors that of proposed rule 3A.29 applicable to sponsors by requiring financial advisers, whether a corporation or an individual, to disclose their interests in the listed issuer, its group and/or the subject transaction in all relevant documents published by the listed issuer. This proposed rule is consistent with the Exchange's promulgation of a disclosure-based market.
- 3A.89** Proposed rule 3A.89 stipulates that each transaction undertaken by a financial adviser, being a corporation, must be handled by at least one Principal Supervisor and one Assistant Supervisor. This manpower requirement is consistent with proposed rule 3A.20 (for sponsors) and proposed rule 3A.77 (for sponsors retained over the Fixed Period). The Exchange considers that the minimum level of manpower and experience must be stipulated to ensure that financial advisers are able to properly discharge their duties and obligations to both the listed issuer and the Exchange pursuant to the Listing Rules.

The Exchange invites comments on proposed rules 3A.82 to 3A.89 relating to the basic qualification and eligibility criteria for financial advisers.

2.3.2 Responsibilities of Financial Advisers (rules 3A.90 to 3A.94)

The provisions in relation to financial advisers set out in this section follow closely the requirements for sponsors as they assume similar roles and obligations. These include, inter alia, the need for financial advisers to:

- 3A.90** discharge their duties and responsibilities in a timely manner and to the satisfaction of the Exchange;

- 3A.91** guide the listed issuer on the interpretation and application of the Listing Rules, the Takeover Code, the Code on Share Repurchases and all other relevant legislation;
- 3A.92** be closely involved in the preparation of all documents to ensure that all information provided to the Exchange is true, accurate and complete;
- 3A.93** deal with the Exchange in respect of a transaction for which it is responsible; and
- 3A.94** observe the highest professional standards and conduct.

The Exchange invites comments on the provisions relating to the responsibilities of financial advisers.

2.3.3 Independent Financial Advisers (rules 3A.95 to 3A.97)

As explained, *all* financial advisers are expected to satisfy the basic qualification and eligibility criteria set out under proposed rules 3A.83 to 3A.94. However, this section has been introduced to emphasize the special provisions relating to financial advisers who have been appointed to advise the independent board committee or the independent shareholders of a listed issuer on, in particular, the fair and reasonableness of the terms of a connected transaction.

The Exchange considers that proposed rules 3A.95 to 3A.97 are necessary to distinguish the interests of the shareholders and connected persons of a listed issuer in a particular transaction. Due to the conflicting interests of these parties, it is necessary to ensure that a prospective financial adviser is able to demonstrate its impartiality before agreeing to accept the role of an IFA. The rationale behind the introduction of provisions relating to IFAs is explained below:

- 3A.95** In order to ensure impartiality, a prospective IFA must not have acted as a financial adviser to the listed issuer, its subsidiaries or any of their respective connected persons for a period of 2 years prior to its appointment.
- 3A.96** A sponsor will not be eligible to act in the capacity of an IFA until 2 years from the relevant listed issuer's date of listing on the Exchange or until 2 years from the end of the Fixed Period, as the case may be.

The 2-year timeframe under proposed rules 3A.95 and 3A.96 has been extended from the Exchange's current requirement of one year but is in line with the Commission's approach to the administration of the Takeover Code which imposes a similar ban on financial advisers and sponsors from acting as IFAs.

- 3A.97** This rule provides that IFAs must ensure that all information they consider relevant for the independent shareholders of the listed issuer to make an informed decision must be disclosed and properly analysed in any document published by the listed issuer.

On numerous occasions in the past, the Exchange has noticed that the letter from the IFA, which forms an integral part of a listed issuer's circular or document, merely repeats the terms of the transaction in question. In these cases, the IFA had not even attempted to analyse the terms of the relevant agreement or the impact the transaction would have on the listed issuer or its shareholders. On this basis, the objective of proposed rule 3A.97 is to ensure that IFAs obtain sufficient information to be able to make and validate its opinion on the fairness and reasonableness of the terms of the relevant transaction.

The Exchange now invites comments on proposed rules 3A.95 to 3A.97 in relation to provisions concerning IFAs.

2.4 SANCTIONS AGAINST SPONSORS AND FINANCIAL ADVISERS (rules 3A.98 to 3A.102)

Under the current Listing Rules, the Exchange may only refer any breaches of responsibilities by a listed issuer or its directors to the Listing Committee for action. However, under the provisions of Chapter 3A, the Exchange proposes to refer any breaches of responsibilities by a sponsor or a financial adviser to the Listing Committee or an appropriate body within the Exchange in order to stress the seriousness the Exchange places on such breaches. The major provisions under this section are summarized below:

3A.99 Proposed rule 3A.99 lists the possible sanctions that may be taken against the sponsor, financial adviser or any of their employees. In addition to the widely accepted sanctions of, inter alia, private reprimand, public statements of criticism and public censorship, the Exchange proposes to introduce the following additional courses of action under certain subparagraphs of this rule:

- Removal of a sponsor from the list of sponsors whether or not for a stated period.
- Bar a sponsor or financial adviser from representing a specified party in relation to a stipulated matter(s).
- Report the sponsor's or the financial adviser's conduct to the Commission or any other regulatory authorities in Hong Kong or elsewhere.
- Request the Commission to consider withdrawing or revoking the sponsor's or the financial adviser's licence.

The above provisions enforce the importance the Exchange places on the responsibilities of sponsors and financial advisers and the manner in which they discharge their duties and obligations. However, the extent of and duration to be imposed by the Exchange will ultimately depend on the nature and magnitude of the breach.

Pursuant to sub-paragraphs (8) and (9), the Exchange may exercise its discretion to require a sponsor or a financial adviser to, where possible, rectify or undertake remedial action for its breaches or any other action appropriate in the circumstances. Pursuant to sub-paragraph (10), as with sanctions currently undertaken against listed issuers and its directors, the Exchange now reserves the right to publish any actions taken against a sponsor or a financial adviser and the reasons relating thereto.

3A.100 The sanctions listed in proposed rule 3A.99 may also be imposed on any director or employee of the sponsor or financial adviser.

3A.101 Pursuant to this rule, any aggrieved party may resort to the procedures for appeal as set out under Chapter 2A of the Listing Rules. The provision aims to ensure that the sanctioned sponsor or financial adviser is given a fair hearing to its case.

The Exchange now invites comments on the list of sanctions against sponsors and financial advisers under proposed rules 3A.99 and 3A.100

3A.102 This rule provides that any sponsor, financial adviser or employee sanctioned pursuant to proposed rule 3A.99 may not be involved in any sponsorship or advisory activities, whether solely or otherwise, for a period of one year (or such other period to be determined by the Exchange) from the date of the sanction.

The Exchange considers this provision would act as a deterrent to parties from intentionally breaching their responsibilities under the Listing Rules.

The Exchange now invites comments on the provision of proposed rule 3A.102 and, in particular, the one-year ban referred to in this rule.