THE HONG KONG INSTITUTE OF COMPANY SECRETARIES
香港公司秘書公會

To: RW

Ms Karen Lee
Executive Vice President
Head of Listing, Regulation and Risk Management
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central, Hong Kong

HKEx CEO Office
Date: - 1 AUG 2003

Your Ref: GEM/LG/2003/129

30 July 2003

By Post & By Fax (2295-3599)

Dear Karen,

Consultation on the Regulation of Sponsors and Independent Financial Advisers

Thank you for your letter of 30 May 2003 addressed to Ms Samantha Suen, President of the Institute, to which I refer.

I have pleasure in enclosing the Institute's position paper on the above-referenced consultation.

With best regards,

Linda Wong
Director, Professional Development

Encl.

LW/cc

Cc Corporate Finance Division, Securities and Futures Commission (fax no.2810-5385)
Ms Samantha Suen, HKICS President (fax no.2530-3004)

The Hong Kong Institute of Company Secretaries 香港公司秘書公會
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ICSA

Response to the Hong Kong Exchanges and Clearing Limited & Securities and Futures Commission Consultation Paper on the Regulation of Sponsors & Independent Financial Advisers by The Hong Kong Institute of Company Secretaries

Acceptable Sponsor Firms & Independent Financial Adviser (IFA) Firms (Paragraphs 50-53 of the Consultation Paper)

Proposal	Response
1. HKEx to maintain a list each of acceptable sponsors and IFAs. Only firms on the lists may act as Sponsors to new applicants or listed issuers or as IFAs to issuers in connected party transactions.	**1. Agree**
2. SEHK (a) may refuse an application for admission to the lists; and (b) may delete names from the lists if established criteria are not satisfied.	**2. Agree**
3. *Listing Division to make all first instance decision on (a) eligibility upon application; (b) on-going eligibility; and (c) independence of* applicants. Where necessary, Listing Committee will review.	**3. Agree**

Acceptable Individuals (Paragraphs 54-59 of the Consultation Paper)

Proposal	Response
1. HKEx to maintain a list of unacceptable individuals who are not permitted to perform sponsor or IFA work	**1. Agree in principle but there should be clear and objective guidelines on criteria and appeals process with rules of natural justice to apply before an individual may be deemed "unacceptable".**
2. Individuals who wish to be engaged in sponsor or IFA work – (a) must be appropriately licensed/registered under the Securities and Futures Ordinance; (b) must work for a sponsor firm or IFA firm, and must be eligible supervisors or perform work under the supervision of an eligible supervisor; and (c) must not be on the list of unacceptable individuals.	**2. Agree**

Criteria for Inclusion on the List of Sponsors & IFAs (Paragraphs 60-97 of the Consultation Paper)

Proposal	Response
1. competence & experience of sponsor & IFA firms (a) focus of requirements on experience of individual member of staff, not sponsor or IFA firms; and (b) "eligible supervisors" – sponsor firms must have at least 4, IFA firms at least 2.	**1. Agree but TWO eligible supervisors for each sponsor & IFA firm.**
2. qualification & experience criteria of eligible supervisors (a) Sponsor "eligible supervisors" (replacing/merging current GEM requirements of Principal Supervisors & Assistant Supervisors) qualification & experience criteria (on-going requirements): • minimum 4 years relevant corporate finance advisory experience derived from companies listed on **recognized stock exchanges** (or other channels (e.g. employment with a SEHK listed issuer) • substantive involvement* in at least 3 completed significant transactions** (at least 1 for a SEHK listed issuer; 1 IPO & 1 transaction completed within the previous 2 years) * = *as a sponsor firm's core transaction team member delivering/managing delivery of at least 1 major components of due diligence work* ** = *excluding an exempt listing document production & listing of investment companies.* (b) IFA "eligible supervisors" – same as sponsors' except only 1 IPO transaction experience required.	**2. Agree but the timeframe to complete at least 3 significant transactions to be within the previous FOUR years.**
3. other factors relevant to the eligibility criteria SEHK to publish factors considered in evaluating admission to sponsors & IFAs lists in exercising discretion to refuse admission or cancel inclusion. Factors proposed – (a) eligibility criteria requirements (including minimum capital, number of eligible supervisors, experience of individual eligible supervisors); (b) applicant's inability to satisfy SEHK of its ability to discharge obligations in para.7 of the proposed Code of Conduct (including having effective supervisory, monitoring & reporting controls; human & technical resources & maintaining proper books & records); (c) current suspension or revocation of regulatory status; and (d) suspension or revocation of regulatory status that has expired but the applicant is unable to satisfy SEHK that appropriate & sufficient remedial steps have been taken.	**3. Disagree as to (a). Criteria should be reasonable so as not to discourage small sponsor/IFA firms, e.g. restriction on minimum share capital or number of staff. Competence and quality are more important factors.**
4. minimum capital requirement of sponsor firms (a) sponsor firms – to 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 & a net tangible asset value after minority interests of not less than HK$10 million*" **OR** • an unconditional & irrevocable guarantee from a company within the sponsor group or an authorized institution of not less than HK$10 million (b) IFA firms – no similar requirements	**4(a) Disagree. Please see above.** **4(b) Agree**

5. undertakings to the Exchange (a) Sponsors & IFAs – • to declare that contents of application to admission to list is true without omitting any material facts • must sign an undertaking* (i) to comply with relevant *Listing Rules applicable to sponsors or IFAs (e.g. proposed Code of Conduct) &* (ii) to assist SEHK with investigations (e.g. by producing documents & answering questions fully & truthfully) (b) Eligible supervisors – same undertaking *as (a) above + duty under the proposed Code to ensure the relevant firm complies with its obligation under the Listing Rules & proposed Code. * *breach of undertaking deemed to be breach of Listing Rules and subject to disciplinary action*	**5. Agree**

Appointment (Paragraphs 98-113 of the Consultation Paper)

Proposal	**Response**
1. IPO - to retain existing requirement of new applicants (including deemed new applicants) to appoint a sponsor to assist through *application process BUT* – (a) co-sponsorship concept will be discontinued (current GEM & Main Board Listing Rules allow firms not qualified as sponsors to act as co-sponsors) (b) for large IPOs with ➢ 1 sponsors one must be designated as "primary sponsor" who must co-ordinate due diligence investigations and ensure sufficient resources are deployed	**1(a) Disagree** **1(b) Agree**
2. Post-IPO – a sponsor firm (may be different from the one for IPO) must be appointed as a financial adviser – (a) for Main Board – for a period ending on publication of the financial results for the 1st full financial year after IPO (b) for GEM – for at least the remainder of the financial year during IPO year and the 2 subsequent financial years (existing requirement)	**2. Agree**
3. To require issuer to seek timely advice from the sponsor during the required period for a number of prescribed events including – (a) any regulatory announcement; circular or financial report announcements; (b) where a notifiable transaction (connected or otherwise) is contemplated; (c) monitoring the use of the proceeds; and (d) adherence to business plans as detailed in the prospectus.	**3. Disagree. It may not be practical for the sponsor to be the only advisor during the relevant period.**
4. To retain existing requirement of issuers to appoint an IFA for – (a) connected party transactions requiring any shareholders to abstain from voting (b) transactions or arrangements requiring controlling shareholders to abstain from voting BUT IFA must be a firm on the acceptable Sponsors or IFAs lists.	**4. Disagree.** **Same comment above applies here.**
5. SEHK to retain discretion to direct an issuer to appoint a sponsor firm to provide it with advice for any period it specifies in the event of a breach of the Listing Rules or investigation of a possible breach.	**5. Agree**

Independence (Paragraphs 114-123 of the Consultation Paper)

Proposal	Response
1. A sponsor must not act for any new applicant or listed issuer (whether as sponsor or joint sponsor) from which it is not independent. Non-independent circumstances include – (a) a sponsor or any member of the sponsor's group : (i) is holding ➢ 5% of the issued share capital of a new applicant; (ii) is controlling the majority of the board of directors of the new applicant (iii) is the new applicant's auditor or reporting accountant (b) the fair value of shareholding referred to in (a) (i) above exceeds 15% of the consolidated net tangible assets of the sponsor group; (c) a sponsor is controlled by or is under the same control as the new applicant; (d) 15% or more of the proceeds raised from an IPO is applied to settle debts due to a member of the sponsor's group; (e) a significant portion of the applicant's operation is funded by the banking facilities provided by a member of the sponsor's group; and (f) where a director or employee of the sponsor or a close family member of either has an interest in or business relationship with the new applicant.	**1. Agree**
2. An IFA is not independent if it has served as a financial adviser to an issuer, its subsidiaries or any of its connected persons in any significant assignment within 2 years of appointment.	**2. Agree but the timeframe to be within ONE year.**
3. Sponsors & IFAs must submit a declaration regarding their independence (addressing each category of potential conflict) at the beginning of any assignment requiring appointment of a sponsor or an IFA.	**3. Agree**

Responsibilities – Reasonable Investigations (Paragraphs 124-147 of the Consultation Paper)

Proposal	Response
To amend the Main Board & GEM Listing Rules to require – 1. **sponsors** to conduct reasonable investigations to satisfy themselves - (a) that "non-expert sections"* in new applicant's listing application & prospectus are true without omitting a material statement required to be stated or to avoid being misleading ; (b) that there are no reasonable grounds to believe that the "expert sections"* in new applicant's listing application or prospectus are not true or omit a material statement materials statement required to be stated or avoid being misleading; AND * *("expert sections" are any apart of a prospectus purporting to be made on the authority of an expert or purporting to be a copy of (or extract from) a report, opinion or statement of an expert. Other parts of the prospectus are the "non expert sections")* (c) that the new applicant is suitable for listing, its directors appreciate the nature of their responsibilities, it and its directors can be expected to honour their obligations under the Listing Rules & the Listing Agreement (existing Main Board Listing Rule 3.04 & GEM Listing Rules 6.47).	**1. Disagree. How is "true" defined? e.g. forecast. No one can certify a forecast is true. Do profit forecast and indebtedness fall into "non-expert" sections"? What falls within "expert sections" with reference to listing application & prospectus should be spelt out.**

IFAs – (a) to take all reasonable steps to satisfy themselves that: (i) the terms & conditions of the transaction or arrangement are fair & reasonable in the interest of the issuer & its shareholders as a whole; & (ii) there are no grounds to believe that any expert advice or opinion relied on are not true or omit a material fact; AND (b) to make a **declaration** in their due diligence report as regards (a)(i) above.	**Disagree. Same comment above in principle applies to (a) (ii) here.**
2. sponsors & IFAs to comply with the new Code of Conduct	**2. Agree**

Code of Conduct for Sponsors & IFAs (Paragraphs 148-165 & Annex 2 of the Consultation Paper)

Proposal	**Response**
1. Approach (a) The Code forms part of the Listing Rules, a breach of its requirements constitutes a breach of the Rules resulting in disciplinary action (b) Various requirements applicable to sponsor & IFA firms, eligible supervisors or a director or staff member of sponsor **OR** IFA firms (c) The Code mirrors the SFC Code of Conduct but contains additional obligations of direct application to sponsors (e.g. due diligence)- • must make site visits & other appropriate enquiries • must conduct own investigations & not relying on statements of directors & senior management in "non-expert sections" of a disclosure document or listing application • duty-bound to conduct more detailed, extensive & intrusive investigations to ensure accuracy & completeness of any problematic statements in either of such sections	**1. Agree**
2. Sponsors & lead underwriters' declaration in listing documents to be registered - (a) presents a fair impression of issuer and use of plain language (b) statement to be made in "non-expert sections": "[Sponsor firm] confirms, at the date of this document, that after reasonable investigation it believes and has reasonable grounds to believe that the information set out in this listing document at [make specific references] is not materially false or misleading" (c) statement to be made in "expert sections": "[Sponsor firm] has 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 **authorized by** [name], is materially false or misleading"	**2. Agree in principle but difficulty in making statement in "expert sections". e.g. How can a sponsor challenge a valuer's valuation?**
3. IFA *due diligence declaration*	**3. Agree**

Reporting Obligations & Monitoring (Paragraphs 166-170 of the Consultation Paper)

Proposal	Response
To replace existing requirement for annual review (applicable to GEM sponsors' list) with a certification process & a targeted programme of monitoring – 1. Sponsors & IFA firms & their eligible supervisors are required – (a) to submit annual confirmations that they remain eligible to act in such capacity (b) to report to SEHK as soon as they became aware if they no longer satisfy the eligibility criteria in the Listing Rules or any information provided by them in connection with their application or continued inclusion on the Sponsors or IFAs lists has changed	**1. Agree**
2. SEHK may conduct a specific review of the continued inclusion of sponsor or IFA firm (or any of its employees) if it becomes aware or has reason to believe suitability may be in question	**2. Agree**
3. SEHK to monitor performance standards using monitoring tools, e.g.: (a) complaints; (b) desk based reviews of transactions; (c) reviews of referrals; (d) liaison with other agencies, professional or regulatory bodies; (e) meetings with management & other representatives of a sponsor/IFA firm; (f) on-site visits after prior notification; (g) reviews of notifications & confirmations from sponsors or IFAs; AND (h) reviews of past service provided & documentation produced.	**3. Agree but an appeal mechanism should be in place.**

Compliance & Sanctions (Paragraphs 171-181 of the Consultation Paper)

Proposal	Response
1. Disciplinary sanctions applicable to all sponsors & IFAs; their eligible supervisors & staff. But all persons licensed as representatives to advise on corporate finance will be entitled to do sponsorship or IFA work under an eligible supervisor unless they have been declared *to be an unacceptable person.*	**1. Agree**
2. A graduated hierarchy of shaming & disabling sanctions (similar to those for issuers & directors) – • private reprimand • public statement with criticism • public censure • declaration of an individual being an unacceptable person or inability to be an eligible supervisor for a specified period of time • suspension of a firm from the list of acceptable sponsors/IFAs for a specified period of time • declaration of an individual being an unacceptable person or inability to be an eligible supervisor; AND • removal of a firm from the list of acceptable sponsors/IFAs	**2. Agree**

Promulgation & Transitional Arrangements (Paragraphs 183-185 of the Consultation Paper)

Proposal	Response
1. 1 year transitional period to require only firms – (a) on acceptable sponsors list be eligible to do sponsor or IFA work (b) on acceptable IFAs lists be eligible to do IFA work so as to allow *firms time to identify potential eligible supervisors & to ensure those individuals have satisfied all relevant requirements.*	**1. Agree but TWO years for transitional period.**
2. Compliance to commence upon promulgation for all other rule changes including requirements that – • sponsors sign the prospectus; • IFAs sign a due diligence declaration in their report; and • Code of Conduct for Sponsors & IFAs.	**2. Agree**

July 2003