CONSULTATION PAPER

ON

THE REGULATION OF

SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

May 2003

SFC
證監會
SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

HKE
Hong Kong Exchanges
and Clearing Limited
香港交易及結算所有限公司

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PREFACE

This Consultation Paper was substantially drafted prior to the publication on 21 March 2003 of the Report by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure ("the Expert Group Report"). The Expert Group Report recommended that a newly created division of the Securities and Futures Commission ("SFC") titled the Hong Kong Listing Authority ("HKLA") be responsible for administering the rules governing the listing of securities ("the Listing Rules"). On 10 April 2003 the Financial Secretary announced that "public consultation would be conducted on the regulation of listing matters and that in the meantime the listing division stays with the Hong Kong Exchanges and Clearing Limited ("HKEx") in the coming twelve to eighteen months". In response both HKEx and the SFC committed to work closely with the Government on measures to raise the quality of the Hong Kong financial market.

The Expert Group Report also stated that "the consultation exercise [on amendments to the Listing Rules to tighten regulation of IPO intermediaries, in particular sponsors and financial advisers] should perhaps be carried out by the SFC."

In drafting this Consultation Paper, HKEx has consulted closely with the SFC and the SFC has indicated that it fully supports the proposals contained in the Consultation Paper. Both HKEx and the SFC agree that amending the Listing Rules to improve regulation of intermediaries, and sponsors in particular, remains a priority and, in view of their respective interests in the regulation of sponsors, that the consultation should proceed on a joint basis.

The Stock Exchange of Hong Kong ("the Exchange") and the SFC invite comments on this Consultation Paper. Comments should reach us by 31 July 2003.

Comments may be sent by paper or by electronic submission by e-mailing a response to the following addresses:

The Exchange	The SFC
Hong Kong Exchanges and Clearing Limited Listing Division 11th Floor, One International Finance Centre 1 Harbour View Street Central Hong Kong Fax: (852) 2295-3599 Email: cvw@hkex.com.hk	Securities and Futures Commission Corporate Finance Division 12th Floor, Edinburgh Tower **(on or before 30 June 2003)** The Landmark 15 Queen's Road Central Hong Kong 8th Floor, Chater House **(After 30 June 2003)** 8 Connaught Road Central Hong Kong Fax: (852) 2810-5385 Email: cfdconsult@hksfc.org.hk

Whilst the Exchange and the SFC welcome comments in any format and with any structure, market participants and members of the public may find it convenient to use the separate questionnaire set out in Annex 3 to submit their views. The use of this questionnaire will make it easier for the Exchange and the SFC to collate and analyse the submissions received. An electronic version of this questionnaire can be found on the HKEx website (www.hkex.com.hk) and the SFC website (www.sfc.org.hk). For those who would like to submit their comments on line, they may do so on the HKEx website.

The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. Statements of the Exchange's policy and the SFC's policy on handling personal data are set out in Annex 4 and Annex 5 respectively.

EXECUTIVE SUMMARY

OBJECTIVE

1. The purpose of this consultation is to seek the views of the market participants on proposals to reinforce the regulatory regime for sponsors, underwriters and independent financial advisers ("IFAs"), as well as seeking comments on issues relevant to other financial intermediaries. This Consultation Paper will be of particular interest to financial intermediaries, listed companies and companies that are interested in being listed on the Exchange.

BACKGROUND

2. The Secretary for Financial Services and the Treasury published the Corporate Governance Action Plan for 2003, on 10th January 2003, a co-ordinated approach by the Administration, the SFC and the Exchange to improve corporate governance. The plan contains measures to tighten the regulation of IPO intermediaries including this consultation exercise and the amendments to the Listing Rules which will follow.

3. The sponsor's role is of special importance in Hong Kong, due to the unusually large proportion of listed companies and listing applicants whose domicile and main operations are located outside the jurisdiction. In the case of Mainland-based private sector companies, verifying information (including the credentials of promoters) presents particular challenges. Particular reliance therefore needs to be placed on the judgement and verification work of the sponsors who bring companies to the market.

4. In the latter part of last year there were a number of corporate scandals and unheralded failures involving Hong Kong listed companies. Notwithstanding allegations of fraud in some of these cases, press and public attention has focussed on the role and responsibilities of those involved in the process of bringing issuers to the market.

5. Comments made in response to criticism support the view that an "expectation gap" concerning the responsibilities of sponsors exists between investors, regulators and some sponsors and raise concerns that some sponsors are not properly discharging the responsibilities, which are normally associated with this important role in developed financial markets. This in turn creates an uneven playing field for those sponsors who are properly discharging their responsibilities. We have therefore decided to put forward proposals to change the Listing Rules to help close the "expectation gap".

SUMMARY OF PROPOSALS

6. This Consultation Paper briefly summarises the background to the consultation and then sets out our proposed changes to the Listing Rules. The key proposals are in short:

- a common regime, administered by the Exchange, to establish the acceptability of corporate finance advisers who wish to act as sponsors or IFAs to prospective applicants or listed issuers on either the Main Board or GEM;

- enhancements and further guidance to clarify the responsibilities of sponsors and IFAs;

- a declaration in a prospectus by the sponsor and lead underwriter about the due diligence work they have performed in providing the Exchange with assurances of the completeness and accuracy of the prospectus;

- mandating that, in addition to sponsor firms and IFA firms, key individuals within the firm (called "Eligible Supervisors") give a personal undertaking to the Exchange to comply with the Listing Rules;

- further guidance to clarify when a sponsor or an IFA may not be regarded as independent of a new applicant or listed issuer and therefore unable to act in such capacity; and

- a requirement for a sponsor to be appointed with responsibilities equivalent to those applicable at IPO where a listed issuer is otherwise producing a listing document.

7. We also consider the role of other professional advisers and steps being taken to ensure that the regulatory frameworks applicable to these firms and individuals promote high standards of conduct and effective disciplinary measures as a deterrent to poor performance.

CONTENT OF THIS CONSULTATION PAPER

8. The context in which our proposals are made is discussed in Part A. Part B sets out the details of the proposals, while Part C considers the role of other professional advisers and relevant initiatives in hand. A summary of the questions posed in this Consultation Paper is included in Annex 3.

NEXT STEPS

9. Many of the proposed changes set out in the Consultation Paper have been discussed informally in recent months with representatives of firms engaged in sponsor work and other independent organisations along with our own Listing Committees. Following these discussions we are now seeking comments from a wider audience including listed companies and companies that are interested in being listed on the Exchange and other market participants.

10. Following the receipt of responses, we anticipate publishing the results and conclusions on or around end of October 2003, with a view to the new rules being published by 1 January 2004.

PART A
BACKGROUND

INTRODUCTION

11. In an increasingly global market for corporate capital the numbers of companies raising capital and listing their securities cross-border is increasing. Evidence of this trend is clear in Hong Kong, where Mainland enterprises are some of the most active in seeking access to competitively priced risk capital.

12. Since June 1993, when the Stock Exchange of Hong Kong (the "Exchange") revised the Listing Rules to facilitate primary market activity by Mainland businesses, approximately 150 Mainland enterprises have been listed on Hong Kong's stock markets and there were, at 30 April 2003, 75 applications in progress from issuers with significant Mainland operations. In the early part of this period, state-owned enterprises were the dominant form of enterprise seeking to be listed. More recently there has been a marked increase in private Mainland enterprises seeking listing, often through holding companies established offshore.

13. Hong Kong aims to position itself to respond to these needs by "maintaining and enhancing our competitiveness as a leading international financial centre and the premier capital formation centre for our country"[1]. The depth and liquidity of our markets and their comparative efficiency and effectiveness in pricing the risk attaching to traded securities are attractive to both potential issuers and investors.

ROLE OF THE EXCHANGE

14. The Exchange plays a central role in positioning Hong Kong's capital markets. In this capacity it seeks to facilitate access to listed markets for a broad range of businesses, whilst at the same time providing an appropriate level of investor protection and seeking to maintain the integrity and competitiveness of the Hong Kong markets. The principal function of the Exchange is to provide a fair, orderly and efficient market for the trading of securities.

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[1] "Enhancing corporate governance" the Hong Kong SAR government's corporate governance action plan for 2003.

15. In furtherance of this, the Exchange has made the Listing Rules. These comprise both requirements which have to be met before securities may be listed and also continuing obligations with which an issuer must comply once listing has been granted. The Listing Rules are designed to ensure that investors have and can maintain confidence in the market and in particular that:

    - applicants are suitable for listing, which generally means that applicants have fulfilled a number of prescribed initial listing criteria;

    - the issue and marketing of securities is conducted in a fair and orderly manner;

    - investors are given sufficient information to enable them to make a timely and properly informed assessment of an issuer;

    - all holders of listed securities of the same class are treated fairly and equally; and

    - the directors of a listed issuer act in the interests of its shareholders as a whole.

16. There is a common misconception that it is the Exchange's role and responsibility to assure investors of the business viability of an issuer. This is not the case. The focus of the Exchange's review is on the adequacy of disclosure and ensuring that an applicant meets a number of prescribed initial listing criteria. Over recent years, and in line with developments in major overseas markets, the Exchange has placed greater emphasis on disclosure as the primary means of providing investor protection on initial listing and on a continuing basis thereafter. Adopting such an approach in Hong Kong avoids the creation of additional regulatory barriers to cross-border activity and helps to keep listing fees and associated costs at reasonable levels. As in other jurisdictions, the regulatory system does not exist to guarantee investors against losses from commercial failure and cannot completely prevent corporate fraud. However, through disclosure and the involvement of professional intermediaries in listing work, a more robust environment can be created for companies seeking to obtain listings, which helps to provide a safeguard against fraud.

APPROVAL OF AN APPLICATION FOR LISTING

17. We summarize below the current model for approving listing applications in Hong Kong.

18. Listing applications are first reviewed by the Listing Division of the Exchange. The Listing Committee then considers the applications. It has the power to approve or reject applications and to impose further conditions for listing where appropriate. Members of the Listing Committee[2] comprise investors, listed company representatives, stockbrokers, investment bankers, legal and accounting advisers, and the Chief Executive of HKEx, the Exchange's parent company, acting as an ex officio member.

19. The Listing Division assesses whether all the relevant qualifications for listing have been met by an issuer on the basis of the prospectus and the submissions provided in support of the listing application. In forming a view as to whether all the relevant requirements for listing have been met by an issuer, the Listing Division will not necessarily accept, at face value, all information provided to it (whether in the text of the prospectus or otherwise by the issuer or its advisers). It reviews the relevant information to ensure that valid concerns are reasonably and properly addressed. Where necessary, the Listing Division asks questions about such information, obtains additional assurances from relevant professional advisers and seeks additional disclosure in the prospectus, if appropriate. The Listing Division does not itself investigate or verify the accuracy or completeness of the information set out in the prospectus and the supporting documents nor does it check the sources of the information or verify those sources. Its role and approach in this regard is consistent with international practice.

20. To ensure the appropriate protection of investors, the Companies Ordinance provides that the directors of an issuer, collectively and individually, are responsible for the accuracy of the information contained in the prospectus, together with any intermediaries that "authorise" the issue of that prospectus.

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[2] Listing Committee members are independent of the Exchange and nominated by a Listing Nominating Committee comprising the Chief Executive and 2 members of the board of HKEx and the Chairman and 2 Executive Directors of the SFC.

21. In satisfying itself that all relevant requirements of the Listing Rules have been complied with, the Listing Division attaches great importance to the role and responsibilities of a sponsor and, where relevant, to the opinions and reports of the issuer's other professional advisers. A new applicant must be advised by a sponsor, usually an exchange participant, issuing house or investment bank who is in a position to offer independent advice and guidance to the issuer to assist it in its preparations for listing. The involvement of the sponsor and also underwriters in the issue of securities at the initial public offering ("IPO") enhances the marketability of the securities, because the public relies on the integrity, independence and expertise of these professionals. The close proximity of sponsors to their client, the issuer, enables them to enjoy superior access to information and an ability to influence disclosure. For these reasons securities regulators around the world choose to place reliance on sponsors, underwriters or similar intermediaries to assist them in discharging their responsibilities. This does not distract in any way from the important principle that the directors of an issuer, collectively and individually, are responsible for the accuracy of the information contained in the prospectus and subsequent disclosures. Clarifying the role and responsibilities of sponsors should, in fact, have the effect of reinforcing the importance of ensuring that directors have the knowledge, competence and integrity to perform their role and meet their responsibilities. In this respect the sponsor has an important transitional role in "coaching" directors in relation to their Listing Rule and legal obligations.

22. In Hong Kong the sponsor to an issuer has an overall responsibility to satisfy itself, on all available information, that the issuer is suitable to be listed, and that its directors appreciate the nature of their responsibilities and can be expected to honour their obligations under the Listing Rules. The sponsor also makes a declaration to the Exchange, based on its due diligence, that the listing document contains all information required by virtue of the Listing Rules and relevant legislation. In effect this is a declaration that the document contains all information that an investor may reasonably require to make an informed assessment of the issuer and the rights attaching to the securities to be listed.

REVISED APPROACH TO VETTING LISTING APPLICATIONS

23. A further factor in establishing Hong Kong's attractiveness to issuers is the efficiency and effectiveness of the listing process. On 24 July 2002 HKEx announced proposals to streamline the listing process and strengthen the procedures for vetting listing applications. These proposals enhance reliance on the integrity and competence of sponsors and other professional advisers.

24. The Listing Rules contain detailed provisions regarding application procedures and requirements, including documentation submission deadlines. The Listing Division has, so far, been flexible in allowing new applicants and their sponsors additional time in making submissions rather than requiring them to adhere strictly to documentation submission deadlines. During the vetting process, the Listing Division has often made detailed comments covering both principal matters and drafting issues such as consistency of disclosure and presentation of the prospectus. This approach may have inadvertently led to the perception by some sponsors that it is the Listing Division, rather than the listing applicants and their sponsors, who are responsible for ensuring the standard and quality of the prospectus. This approach is not conducive to the healthy development of the securities market.

25. It should be noted that the trend in other developed markets is for regulatory authorities to move away from pre-vetting of corporate disclosure materials to post-vetting of documents on a selective basis, with enforcement action being taken against the issuer, its directors and advisers in relation to any defects. This removes any suggestion or perception that the regulatory authority has endorsed the document and unequivocally places responsibility for the document on the directors and advisers. It also helps to conserve regulatory resources for alternative and potentially more effective action, including enforcement. While we are not presently advocating that Hong Kong should immediately adopt a post-vetting regime we believe that, to help the Hong Kong market remain competitive, the ground should be prepared now for the practice of post-vetting, particularly of post-IPO disclosure material.

26. The revised approach embodied in the HKEx's proposed streamlined listing process, as announced last July, is built on the premise that listing applicants and sponsors and professional advisors are responsible for ensuring compliance with all the relevant legal requirements and Listing Rule stipulations, as well as the standard and quality of prospectuses. This approach will lead to considerably less detailed vetting of listing documents and company announcements by HKEx staff, and a correspondingly greater reliance on the work of sponsors and other professional advisers.

27. The sponsor's role is of special importance in Hong Kong, due to the unusually large proportion of listed companies and listing applicants whose domicile and main operations are located outside the jurisdiction. In the case of private Mainland enterprises, verifying information (including the credentials of promoters) presents particular challenges. The China Securities Regulatory Commission ("the CSRC")

has no obligation to supervise or apply quality controls to such companies. As a consequence it may not be possible to obtain timely information and assistance in relation to such companies. Particular reliance therefore needs to be placed on the judgement and verification work of the sponsors who bring companies to the market. This does not reduce the responsibility of directors, but it does increase the need for sponsors to ensure that directors make available all relevant information, thoroughly understand their obligations, and are suitable persons to exercise their fiduciary responsibility.

MAY 2000 CONSULTATION

28. The professional standards of some sponsors were identified by the Exchange as a problem some time ago. This led to the issue in May 2000 of a market consultation paper ("the Chapter 3A Consultation Paper") recommending a new Chapter 3A to the Main Board Listing Rules, which would have spelt out in more detail the duties of Main Board sponsors and would have created a minimum and uniform standard amongst corporations and individuals who are engaged in sponsorship activities and the provision of corporate finance advisory services. The proposals were perceived by the market as creating too many additional burdens and the reaction of market participants, at the time, indicated a widespread reluctance on the part of sponsors to accept more exacting standards and responsibilities.

29. A concurrent consultation exercise in May 2000 by the SFC preceded the introduction of the Corporate Finance Adviser Code of Conduct ("the SFC Code of Conduct") which had some bearing on the role and responsibilities of sponsors. The SFC Code of Conduct was published in December 2001. However, subsequent events indicate that this did not clarify the market's perception of the role of sponsors. Indeed, it has become increasingly clear (as mentioned below) that an "expectation gap" remains between many sponsors (on the one hand) and regulators and investors (on the other hand) about the role and responsibilities of a sponsor.

NEED FOR HIGHER STANDARDS

30. In the latter part of last year there were a number of corporate scandals and unheralded failures involving Hong Kong listed companies. Notwithstanding allegations of fraud in some of these cases, press and public attention has focussed on the role and responsibilities of those involved in the process of bringing issuers to the market. The Financial Affairs Panel of the Legislative Council held a hearing in October 2002 on the procedures for vetting and approving for listing companies incorporated in Mainland China and overseas jurisdictions.

31. In response to criticism of their role, some sponsors were reported in the press to have disclaimed responsibility for the quality of disclosures made at the time of listing. Other sponsors agreed that they have an important role to fulfil in ensuring the completeness and accuracy of disclosure at the time of IPO and in preparing issuers for their life as listed companies. These contrasting comments support the view that an expectation gap exists and raise concerns that some sponsors are not properly discharging their responsibilities. This, in turn creates an uneven playing field for those sponsors who are devoting the necessary resources and diligence to discharge their responsibilities properly.

32. In the absence of effective disciplinary action or pressure exerted on sponsor firms by market forces, failure to discharge a sponsor's responsibilities does not bring with it significant consequences. This results in the risk/reward ratio for sponsor firms becoming "skewed". Our proposals are designed to help redress this imbalance by increasing the probability that a failure to carry out work to the appropriate standards will have consequences for the sponsor firm and individual staff involved in the performance of that work.

33. Furthermore the Exchange's experience of problems arising in the operation of the GEM sponsor regime and dealing with potential breaches of the GEM Listing Rules by issuers and sponsors indicate that there remains a need for the Exchange to clarify what its expectations of sponsors are.

JOINT CORPORATE GOVERNANCE ACTION PLAN FOR 2003

34. As a consequence of the above, the regulation of financial intermediaries is now at the top of the regulatory agenda in Hong Kong. In November 2002 the Secretary for Financial Services and the Treasury outlined the Government's desire to ensure that listing sponsors fulfil their responsibilities. On 10th January 2003 the joint Corporate Governance Action Plan for 2003 ("the Action Plan") agreed between the Government, the SFC and the Exchange was announced by Mr. Frederick Ma, Secretary for Financial Services and the Treasury. This envisaged, among other things, the introduction of proposals to extend the statutory liability for material misstatements in prospectuses to IPO sponsors, and possibly other IPO intermediaries, in order to ensure the quality of disclosure to investors.

35. This consultation exercise is identified as a priority under the Action Plan and is one of the strands of work designed to make an overall improvement to governance in the Hong Kong market. In Part B of the consultation document we set out our proposals for modifying the sponsor regime. We do not pretend that clarifying the role and obligations of sponsors will, by itself, solve all of the issues related to the quality of disclosure, but we expect that it will make a contribution and arrest the potential drift to the lowest common denominator.

DIRECTORS AND OTHER PROFESSIONAL ADVISERS

36. Whilst sponsors have an important role to play in assessing the readiness of a new applicant for listing and vouching for the accuracy of the prospectus, the position of directors and other professional advisers also needs consideration.

37. The directors of an issuer are collectively responsible for the management and operations of the issuer and are accountable to the issuer's shareholders. Compliance with the Listing Rules by directors includes fulfilling their fiduciary duties and exercising due skill, care and diligence in carrying out their duties. Such standards are established in Hong Kong law and in similar statute overseas. It is implicit that, in order to comply with the disclosure obligations placed on issuers, board members must thoroughly understand their obligations as well as ensuring that the issuer has adequate financial and compliance reporting procedures in place.

38. The Exchange's experience in monitoring the conduct of listed issuers and the feedback from recent consultations we have undertaken raise issues about the adequacy of the measures taken by sponsor firms to prepare directors for life as board members of listed companies, and about the availability of relevant training for such directors. An initiative is in hand to address the latter point. The Exchange and the Institute of Directors are working together to develop suitable training programmes. In the proposed Code of Conduct for Sponsors and Independent Financial Advisers at Annex 2 to the consultation document we describe the role of sponsors in assessing the suitability of directors and our expectations.

39. Under the Companies Ordinance, directors of an issuer (collectively and individually) are responsible for the accuracy of the information contained in the prospectus. Other experts take responsibility for the accuracy and reliability of disclosures they authorise to be made in the prospectus and for information and explanations provided to the Exchange during its review of the listing application. The main categories of professional adviser are:

    - legal advisers, which are usually solicitors with practicing certificates from the Law Society of Hong Kong, but may include foreign legal practitioners from the domestic jurisdiction of the listed issuer or elsewhere;

    - professional accountants acting as independent reporting accountants in IPOs and in significant post-listing transactions, reporting to the listed issuer;

    - professional accountants acting as auditors of the listed issuer appointed under the Companies Ordinance and reporting to the shareholders of the listed issuer; and

    - appraisers and valuers.

40. These professionals function as independent advisers to the company (or, in the case of auditors, the shareholders, and in the case of the solicitor for the sponsor/ underwriters, the sponsor) and perform functions in the regulatory framework which are distinct from those of sponsors and, to a lesser extent, financial advisers. The corporate scandals and failures mentioned above raise concerns about whether some of these professionals are also discharging their responsibilities and whether the regulatory framework applicable to them commands market confidence.

41. Lawyers and accountants in Hong Kong operate within their own established regulatory framework, governed by self-regulating quasi-statutory bodies. In the case of appraisers and valuers, the Hong Kong Institute of Surveyors does not enjoy similar statutory recognition and its interest in appraisal work is generally limited to real estate asset and related business valuations. At present there is no statutory or similar professional body for the broad range of other advisers involved in appraisal work in other fields, such as appraisers of oil and gas reserves, patents, brand names, mastheads and other forms of intellectual property. In Part C of the consultation document we describe current arrangements between the Exchange and these professions and initiatives in hand. In the light of these initiatives the Exchange is not proposing any new requirements in the present consultation exercise. The Exchange will monitor these developments and consider what further steps are necessary in due course.

42. One initiative which is highly relevant to the role and responsibility of intermediaries in general is the proposal put forward by the SFC to the Standing Committee on Company Law Reform ("SCCLR") (as indicated in the Corporate Governance Action Plan mentioned above) with a view to extending prospectus-related liability in the Companies Ordinance to IPO sponsors, and possibly other IPO intermediaries. This would involve making amendments to the Companies Ordinance concerning civil and criminal liability for misstatements in prospectuses (sections 40 and 40A together with their equivalents in Part XII of the Ordinance). If it is agreed that these proposals should proceed, there is likely to be a time lag before amendments to statute come into force. In Part B of the consultation document we set out more immediate proposals which will require sponsors and lead underwriters to authorise a statement relating to the due diligence they have undertaken in respect of that prospectus. We believe that such an explicit statement will achieve substantially the same result and therefore have a positive effect on the quality of disclosure by applicants at the time of listing.

PART B
ELIGIBILITY CRITERIA FOR AND RESPONSIBILITIES OF SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

A SINGLE REGIME

43. The Exchange proposes to introduce new rules and amendments to the existing Listing Rules to establish minimum and uniform standards among corporations and individuals who are engaged in sponsorship activities and the provision of corporate advisory services to Main Board and GEM applicants and issuers.

44. Hong Kong's legal system and its financial services regulatory regime is largely based on that of the United Kingdom, for obvious historical reasons, but adapted to suit Hong Kong's specific circumstances. The sponsor regime has developed over a long period and the extent of its codification varies between GEM and the Main Board.

45. The current GEM Listing Rules contain both quantitative and qualitative requirements relating to qualification and experience of GEM sponsors, with emphasis on both the sponsor firm and the individual members of staff engaged in the provision of corporate finance advisory services. Prospective GEM sponsors and their staff are required to meet the relevant criteria in order to be approved for admission to the Exchange's sponsor list. The existing Main Board Listing Rules do not contain any express provisions in this respect.

46. The current Main Board Listing Rules and Model Code for Sponsors prescribe a number of responsibilities applicable to sponsors in general terms. The existing GEM Listing Rules, on the other hand, prescribe in detail the duties and responsibilities of sponsors and the standards expected of them.

47. Our proposals draw on the current GEM Listing Rules, on the standards imposed by the UK Listing Authority ("UKLA") on sponsors in the London market, and on the sponsorship policy statements of the Toronto Stock Exchange ("TSX") in Canada. Although every market has a role for a professional advisor, in the United Kingdom and Canada this role has been formalised to a greater extent than in most other markets, to help ensure that a high level of due diligence is undertaken in respect of significant transactions involving listed issuers, including IPOs. The

UKLA does not currently set any specific criteria for the due diligence it expects a sponsor to undertake (or have undertaken on its behalf), although it does establish criteria for approval, function and appointment of a sponsor.

48. We have also drawn on experience from the United States. For comparative purposes, we set out as Annex 1 a description of the approaches taken to financial intermediary due diligence in the United States, Australia, Canada and United Kingdom.

49. The proposals discussed in greater detail below will establish a common regime for the Main Board and GEM with the following features:

List of acceptable sponsors and IFAs: the Exchange may refuse an application as a sponsor or cancel a sponsor's acceptance if the Exchange considers that the sponsor or sponsor applicant does not satisfy the criteria established in order for the firm to be included on the list of acceptable sponsors maintained by the Exchange. A separate list of acceptable IFAs will also be maintained. Only firms on the list of Sponsors or IFAs will be eligible to undertake IFA work. The Exchange will also maintain a list of individuals declared, after due process, to be unacceptable and therefore unable to carry out sponsorship or IFA work.

Criteria for inclusion on the list of sponsors:

- a body corporate;

- appropriately registered/licensed under the Securities and Futures Ordinance ("SFO") or deemed under transitional arrangements to be registered/licensed under the SFO. These transitional arrangements will cease to apply on 31 March 2005;

- have at least four eligible supervisors who are in senior positions within the sponsor firm and are licensed or deemed to be licensed under the SFO;

- satisfy the Exchange that it is able to discharge its responsibilities as a sponsor;

- meet and maintain a minimum capital requirement; and

- provide itself and procure from each eligible supervisor a contractual undertaking to the Exchange with respect to compliance with obligations imposed on them.

Criteria for inclusion on the list of IFAs:

- a body corporate;

- appropriately registered/licensed under the SFO or deemed under transitional arrangements to be registered/licensed under the SFO;

- have at least two eligible supervisors who are in senior positions within the sponsor firm or IFA firm and are licensed or deemed to be licensed under the SFO;

- satisfy the Exchange that it is able to discharge its responsibilities as an IFA; and

- provide itself and procure from each eligible supervisor a contractual undertaking to the Exchange with respect to compliance with obligations imposed on them.

Individuals able to do sponsor or IFA work. Any individual may do sponsor or IFA work provided:

- they are appropriately registered/licensed under the SFO or deemed to be so;

- they are supervised by an eligible supervisor; and

- they have not been listed as an unacceptable person.

Appointment: an applicant for listing must appoint a sponsor and a listed issuer in certain circumstances will be required to appoint a sponsor. A listed issuer must appoint an IFA in respect of connected transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain from voting.

Independence: a sponsor or an IFA must not act for an issuer from which it is not independent except with the Exchange's specific permission. When a sponsor or an IFA is appointed it must submit a confirmation of independence with any draft documentation submitted to the Exchange for review.

Responsibilities: the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers (which is at Annex 2) will set out the responsibilities that a sponsor and an IFA is required to discharge and will provide a non-exhaustive list of examples of due diligence investigations sponsors and IFAs would be expected to perform. In addition we propose including a requirement that the sponsor make a declaration in a prospectus in relation to the due diligence it has performed and that an IFA make a declaration in its report in relation to the due diligence it has performed.

Reporting obligations: a sponsor or an IFA must notify the Exchange in writing immediately of an event or other factors, which impact its ability to meet the eligibility criteria. Sponsors, IFAs and their eligible supervisors will submit confirmations of their continuing eligibility on an annual basis.

Monitoring: the Exchange will use a variety of methods to monitor whether sponsors and IFAs remain in compliance with the Listing Rules applicable to them. The Exchange will adopt a risk-based approach to enhance the efficiency and effectiveness of the process of monitoring issuers, sponsors and IFAs.

Compliance and Sanctions: sponsors and IFAs and their eligible supervisors and staff must comply with all rules applicable to them. If the Exchange considers that a sponsor or IFA or their eligible supervisors or staff has breached or failed to discharge any of its responsibilities or obligations under the Listing Rules, a range of proportionate disciplinary measures will be available to it.

ELIGIBILITY TO CONDUCT SPONSOR OR IFA WORK

50. To be eligible to act as a GEM sponsor, the current GEM Listing Rules require the party in question to have been approved by the Exchange for such purpose and admitted to a list of sponsors maintained by the Exchange from time to time[3]. As a minimum, any prospective sponsor is expected to meet the eligibility criteria[4] and undertake to comply with the GEM Listing Rules applicable to sponsors[5] before the Exchange will consider admitting it to the list of sponsors. Furthermore, under the current GEM Listing Rules, the Exchange will ordinarily review the sponsor's continuing eligibility on an annual basis[6]. Similar provisions were proposed in the Chapter 3A Consultation Paper.

51. Under the SFC's licensing regime, a corporate finance adviser (including a sponsor firm) and its relevant professional staff must be properly licensed or deemed to be licensed by the SFC for Type 6 regulated activity viz advising on corporate finance. The firm and its professional staff must satisfy the SFC that it is fit and proper in order to be granted a licence. In considering fitness and properness, the SFC will have regard to various factors[7] relating to the applicant, including qualification or experience, having regard to the functions to be performed. The SFC has also issued a code, the "Corporate Finance Adviser Code of Conduct", which is used as a benchmark, together with other SFC codes and guidelines, against which a corporate finance adviser's continuing fitness and properness will be measured. Furthermore, under the licensing requirements of the SFC, annual returns must be filed and any changes in information provided by the sponsor or its relevant professional staff must be reported.

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[3] See Rule 6.04 of the GEM Listing Rules

[4] See Rules 6.12 to 6.19 of the GEM Listing Rules

[5] See Rule 6.20 of the GEM Listing Rules

[6] See Rule 6.05 of the GEM Listing Rules

[7] See SFC's "Fit and Proper Guidelines". The factors taken into consideration include: (i) financial status or solvency; (ii) education or other qualifications or experience having regard to the functions to be performed; (iii) ability to carry on the regulated activity efficiently, honestly and fairly; and (iv) reputation, character, financial integrity and reliability.

52. We propose that to be eligible to act as a sponsor of a new applicant or a listed issuer, the firm and its qualified senior members of staff (eligible supervisors) must be acceptable to the Exchange for such purposes and admitted to a list of acceptable sponsors maintained by the Exchange. Similarly, we propose that to be eligible to act as an IFA under the Listing Rules, the firm and its eligible supervisors must either be on the list of acceptable sponsors or must be admitted to the list of acceptable IFAs.

53. Similar registration schemes are operated in the United Kingdom, Canada and Ireland for sponsors.

54. Apart from the list of eligible supervisors, the Exchange does not propose having a list of individuals who are eligible to perform sponsor or IFA work. However, the Exchange will maintain a list of unacceptable individuals, that is a list of individuals who are not permitted to perform sponsor or IFA work. Any individual who is a staff member of the sponsor firm or IFA firm registered/licensed under the SFO or deemed to be registered/licensed under the SFO may do sponsor or IFA work under the supervision of an eligible supervisor provided he or she is not on the list of unacceptable persons. The list of unacceptable individuals will be made public on the HKEx website.

55. Before proposing the above acceptable and unacceptable lists, the Exchange has considered carefully whether they are strictly necessary, in the light of the SFC's existing licensing requirements, and whether the latter could achieve the desired effect on their own. The Exchange is also mindful of the need to avoid creating unnecessary barriers to entry for new corporate finance firms. However, in light of the gate-keeper role performed by sponsors in relation to the suitability of applicants for listing and adequacy of initial and continuing disclosure by an issuer, the Exchange has concluded that the system proposed in this consultation document is necessary to preserve the reputation and integrity of Hong Kong's equity market.

56. The principal purpose of the pre-registration and also the current annual review requirements is to ensure that sponsors meet on a continuing basis high standards of professionalism, competence and integrity in their work related to stock exchange listings. Furthermore, registration serves to reinforce the necessary nexus, or linkage, between professional intermediaries and ourselves as market regulator.

57. The SFC's licensing regime covers a much wider spectrum of regulated persons and has a broader focus than the Exchange's existing and proposed registration requirements. The SFC's regime seeks to ensure the general fitness and properness of regulated persons, not their specific abilities and qualifications in respect of each area of business that they might conduct. As the Exchange relies directly on the work performed by sponsors, it is only appropriate that the Exchange has the final say in determining who should be permitted to perform that work, what the standards of performance should be and, importantly, how to address poor performance by sponsors.

58. Pre-registration and maintaining a list of sponsors and a list of IFAs provides the necessary framework for the Exchange to monitor the work of professional intermediaries and, if necessary, to exclude from the market poorly performing firms or individuals, which in turn will enhance market integrity and confidence.

59. Given that there will inevitably be a degree of overlap between the SFC's regime (including extended powers under the dual filing arrangements introduced by the SFO on 1 April 2003) and the Exchange's sponsor and IFA regime, close liaison, co-operation and a clear strategy to deal with enforcement cases of mutual interest will be necessary. Suitable arrangements are being put in place.

CRITERIA FOR INCLUSION ON THE LISTS OF SPONSORS AND IFAs

Competence and experience of the sponsor

60. Under the current GEM Listing Rules, a prospective sponsor is required to have the following experience in order to be admitted onto the Exchange's sponsor list[8]:

- acted as a sponsor in at least 2 completed IPO transactions on the Exchange during the 5-year period before application; or

- acted as a co-sponsor in at least 3 completed IPO transactions on the Exchange over the same period.

[8] See Rule 6.14 of the GEM Listing Rules

61. The Chapter 3A Consultation Paper further proposed that at least one of such incidences of sponsoring would need to be completed during the period of one year before the application.

62. It has been the practice of the Main Board, as published on our website in July 2001 as part of Listing Decision series 27, that, in order for a financial adviser to be eligible to act as a sole sponsor in a new listing application on the Main Board, it must have previously acted as a co-sponsor in a number of successful listing applications. Furthermore, as published on our website in March 2000 as part of Listing Decision series 11, in order for a financial adviser to be eligible to act as a co-sponsor in a new listing application on the Main Board, both the financial advisory firm and members of its staff must have substantial corporate finance experience.

63. It has been suggested by some market participants that the present requirements discriminate against newly established firms because such firms will, by definition, not have a track record, even if they have directors and employees who have gained extensive experience in other financial institutions. It is therefore suggested that the focus of our requirements should place greater weight on experience of professional staff, rather than of the sponsor firm itself. We agree.

64. The principal purpose of establishing eligibility criteria was to ensure that the firm had the width and breadth of experience demanded of a sponsor. However, we have witnessed numerous instances where firms have acted as co-sponsors to new listing applicants in name only. We have also encountered instances where the lead sponsor was not able to provide information requested by the Exchange and had to ask the co-sponsor to provide the necessary information. Such experiences do not give us comfort in those arrangements; we also believe that, in some cases, such arrangements made were solely for the purpose of satisfying the Main Board's practice and the GEM Listing Rules on the experience required of sponsor firms, and thus appear to defeat the principal purpose of such requirements.

65. More importantly, we consider the experience of an individual member of staff to be more crucial than the experience of the sponsor firm, as responsibility for handling and supervising the sponsor's work on a new listing application falls to individuals. We also note that the UKLA concentrates only on the experience of individual staff members rather than on the experience of the firm.

66. We therefore propose that the focus of our revised requirements will be on the experience of the individual member of staff, rather than the sponsor firm. Sponsor firms will continue to be subject to other criteria as noted below.

Qualification and experience criteria of eligible supervisors

67. Under the existing GEM Listing Rules, each sponsor firm is required to have, at all times, a minimum of two Principal Supervisors and a minimum of two Assistant Supervisors. Each Principal Supervisor and Assistant Supervisor is required to have sufficient relevant corporate finance experience in respect of companies listed on the Exchange prior to the Exchange's acceptance of his/her role as supervisor of the sponsor firm. The Exchange will, in some cases, accept a Supervisor's experience gained over a period in excess of 5 years' or 3 years' (as the case may be) prior to the date of declaration[9].

68. "Corporate finance experience" is defined under the existing GEM Listing Rules as experience derived from providing advice on matters in relation to Listing Rules, Takeover Code and/or other appropriate and significant transactions or equity-fund raising exercises[10].

69. The Chapter 3A Consultation Paper proposed similar experience criteria but did not recognize IPO transactions and corporate finance experience gained from overseas exchanges.

70. It has been suggested by some market participants that the Exchange should reduce the number of completed IPO transactions in which a Principal Supervisor needs to have been involved from 2 to 1 and that the Exchange should also recognize corporate finance and fund-raising experience gained in both public and private capacities in Hong Kong and overseas; also that the focus should be on an individual's experience, and not corporate title, and thus it should not be a pre-condition that a Principal Supervisor must be a member of the board of the sponsor.

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[9] See Rules 6.16 and 6.17 of the GEM Listing Rules.

[10] See Rule 6.14, Note 2 of the GEM Listing Rules.

71. Under the SFC licensing criteria, each licensed corporation must appoint at least 2 responsible officers to supervise each of the regulated activities which it is licensed to carry on. Each executive director who is an individual will be required to act as a responsible officer. A responsible officer must have, depending on the educational level, the equivalent of 3 years', 5 years' or 8 years' relevant industry experience and not less than 2 years' management experience. Other licensed representatives do not need to have relevant industry experience if their educational attainments are above a prescribed level. Individuals in either category need to pass recognized local regulatory framework examinations.

72. The UKLA requires a sponsor firm to have at least four "eligible employees" at all times. The UKLA defines an "eligible employee" as being a director, partner or employee who has given advice in connection with at least three significant transactions[11] in the previous 36 months, at least one of which must have been in the previous 12 months. This is an on-going requirement[12]. Furthermore, an "eligible employee" must be a senior member of a sponsor firm.

73. The purpose of the experience requirement is to provide a minimum benchmark against which to assess whether an individual appears to have the knowledge and experience necessary to manage the application procedure for a listing application in a competent manner and advise his client on the application and interpretation of the Listing Rules. In light of our proposal to concentrate on the experience of individual members of staff rather than the sponsor firm, we feel that it is important to ensure that these individuals have the requisite experience to discharge their

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[11] The UKLA will generally consider advice given in connection with a significant transaction to mean advice given in relation to the application and interpretation of the UK Listing Rules or the Alternative Investment Market ("AIM") rules. It will accept the following transactions as "significant transactions": (i) an initial public offer; (ii) a Class 1 transaction; (iii) a related party transaction involving the preparation of a circular; (iv) any other issue of securities involving the preparation of listing particulars; (v) preparation of listing particulars or a prospectus for submission to, and approval by, the UKLA or another authority in an EU member state; and (vi) acting in the capacity of nominated adviser when admitting a company to trading on AIM. Transactions involving the production of an exempt listing document are not considered significant transaction.

[12] If an "eligible employee" fails to provide advice in connection with at least one significant transaction within the previous 12 months, such employee ceases to be an "eligible employee".

obligations. However, we recognise that creating two categories of eligible personnel may not best serve our needs, and consequently, we propose to merge the requirements relating to qualification and experience criteria for Principal Supervisors and Assistant Supervisors into a single new category of Eligible Supervisor. We suggest that a sponsor firm be required to have at least four Eligible Supervisors.

74. We also propose to recognise overseas experience for the purposes of our assessment of individuals. Under the proposed experience requirements for Principal Supervisors and Assistant Supervisors contained in the Chapter 3A Consultation Paper, only experience derived in relation to issuers listed on the Exchange would have been recognised. The existing GEM Listing Rules on sponsors, on the other hand, accept experience derived from recognized overseas exchanges (such as NYSE, NASDAQ, SGX, ASX, and London Stock Exchange), provided that a substantial part of that experience has been derived from work relating to companies listed on the Exchange. Whilst we consider that individual members of staff should possess relevant experience so as to enable them to discharge properly their obligations, we believe that criteria, which recognise "local experience" only, may be too stringent. However it is important for eligible supervisors to understand and have experience of the Hong Kong Listing Rules so that they can advise their clients in an appropriate and well-informed manner. Accordingly, we propose that our criteria for experience will include a requirement for experience of at least one significant transaction in the Hong Kong markets.

75. We propose that an Eligible Supervisor be required to have at least 4 years of relevant corporate finance advisory experience derived in respect of companies listed on recognised stock exchanges or from other channels, such as relevant corporate finance experience gained from employment with an issuer listed on the Exchange. Further requirements will be to demonstrate that they have played a substantive role in at least three significant transactions, which have been completed. At least one of those transactions must be in respect of a company listed on the Exchange. At least one of the transactions must have been completed within the previous two years. At least one of the transactions must be an IPO. A substantive role means a role as a member of the sponsor firm's core transaction team in delivering or managing the delivery of one or more of the major components of due diligence work undertaken in respect of an engagement. These requirements will be on going requirements.

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

77. We believe our proposed criteria for the experience required of an Eligible Supervisor will ensure that there are individuals in the sponsor firms who have the requisite experience to discharge the obligations imposed on sponsors and to supervise less experienced individuals engaged in sponsorship work. The further codification of the eligibility requirements will increase transparency of our requirements and help us to deal with individuals who claim but cannot substantiate that they have recent relevant corporate finance experience. Experience derived from other activities not directly connected to the provision of corporate financial advice, such as writing research reports, and experiences gained prior to the relevant periods, whilst contributing to the overall knowledge and experience of an individual, will not be relevant for the purposes of our criteria.

78. Under the existing GEM Listing Rules, a prospective sponsor must have a minimum of two executive directors engaged in a full time capacity in the prospective sponsor's corporate finance business in Hong Kong. A number of waivers have been granted where it was the policy of the sponsor firm to appoint executive directors only at the head office level, which may not be located in Hong Kong. Accordingly we propose to retain a modified requirement which will incorporate the principle that the sponsorship activities of the firm must be under the supervision and direction of senior staff who are qualified as eligible supervisors.

79. We propose that an IFA firm be required to have at least 2 Eligible Supervisors and that IFA eligible supervisors meet the same qualification and experience requirements as for sponsor eligible supervisors, but IFA eligible supervisors will not be required to have done one IPO transaction.

Other factors relevant to the acceptability of sponsors

80. In assessing a prospective sponsor's application or an existing sponsor's ongoing suitability, the Exchange may have regard to a range of factors relevant to the sponsor firm's ability to discharge its responsibilities. We propose to retain discretion for the Exchange to refuse or cancel a sponsor's acceptance. The Exchange may ask a sponsor or prospective sponsor to provide further information during the assessment of its application. To provide clarity about the circumstances in which the Exchange may consider exercising this discretion we will publish details of the factors we will take into account in making an evaluation. The proposed factors include the following:

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

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

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

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

Other factors relevant to the acceptability of IFA firms

81. We propose that the same factors be taken into account in determining the acceptability of IFAs as are taken into account for sponsors, save for the minimum capital adequacy requirement. There is no current minimum capital requirement for IFAs under existing practice and the Listing Rules, and taking into account the range, scale and complexity of services they will provide by contrast to sponsor firms, we do not believe that there are the same compelling reasons to impose this requirement.

Minimum Capital Requirement of Sponsor Firms

82. The existing GEM Listing Rules require sponsor firms to meet and maintain a minimum capital requirement of *"total paid-up share capital and/or non-distributable reserves of not less than HK$10 million represented by unencumbered assets and a net tangible asset value after minority interests of not less than HK$10 million"*. Furthermore should the sponsor firm be unable to meet the capital requirement, the Exchange *"would accept an unconditional and irrevocable guarantee from a company within the sponsor group or an authorized institution of not less than HK$10 million"*. In the event that such value falls below HK$10 million, sponsor firms may not take on any new sponsorship role for a new applicant or listed issuer (or continue to advise any new applicant) until such time as the value has been restored[13]. Similar provisions were proposed in the Chapter 3A Consultation Paper.

83. We propose to retain the existing GEM requirements together with the relevant associated requirements.

84. It has been suggested by some market participants that the capital requirements are unfair to smaller firms, since the SFC's Financial Resources Rules only require a liquid capital value of not less than HK$100,000 at all times for a corporate finance adviser that does not hold client assets. It has also been suggested that, where a sponsor is undertaking an advisory role and not participating in underwriting new issues, the capital requirement should not apply to such sponsor. We are not convinced by these arguments.

85. The principal purpose of establishing capital criteria is to ensure that the sponsor firm has adequate resources to fulfill its role as a sponsor and the responsibility it accepts. As at 31 March 2003, there were 56 financial institutions admitted to the GEM Sponsors' list, comprising international firms as well as local institutions. All of these admitted GEM sponsors fulfill the capital requirement. It is noted that a number of these institutions have a short operating history. Furthermore, a number of the admitted GEM sponsors are only engaged in sponsorships and/or financial advisory activities and do not participate in underwriting new issues.

[13] See Rule 6.21(1) of the GEM Listing Rules

Compliance history

86. The existing GEM Listing Rules require a sponsor to disclose details of any reprimands or disciplinary actions made or taken by a regulatory authority in respect of the sponsor and/or any existing member of staff who actively participates in the provision of general corporate finance advice, investment advice and/or securities dealing. Where a sponsor or any of its members of staff has been publicly censured within the 5 years prior to the sponsor's application, it is unlikely that the prospective sponsor will be regarded as suitable for admission to the list of sponsors.[14]

87. The Chapter 3A Consultation Paper further proposed that the reporting requirement should be extended to the sponsor's ultimate holding company and any of its subsidiaries.

88. It has been suggested by some market participants that this requirement is too onerous for international groups, in particular given the turnover of staff in many firms, and that disciplinary action, however minor and whether or not related to their corporate finance business, needs to be reported. It is suggested that the disclosure should only relate to public censure and any other material disciplinary action relating to corporate finance business, and that the reporting period should be shortened; an additional suggestion is that, where a sponsor has been publicly censured within the prescribed period, this should only constitute a "relevant factor" in considering the prospective sponsor's suitability, rather than being an automatic bar to admission.

89. The SFO requires a sponsor and its relevant professional staff to be properly licensed (or deemed to be licensed). In considering whether a corporate applicant is fit and proper to be licensed, the SFC will look at those matters in respect of the corporation, any of its officers, any other corporation within its group of companies, any substantial shareholder or officer of the corporation or any of its group companies, and any person employed by or associated with the corporation. The SFC may also look at any other businesses carried on by the applicant.

[14] See Rule 6.19 of the GEM Listing Rules

90. It is also noted that the SFC will, when considering if an applicant is fit and proper, take into consideration whether the applicant has, among other things:

    (a) failed to abide by any codes and guidelines promulgated by the SFC, other regulators or any relevant exchanges in Hong Kong or overseas; or

    (b) evidenced incompetence, negligence or mismanagement, which may be indicated by the person having been disciplined by a professional, trade or regulatory body; or dismissed or requested to resign from any position or office for negligence, incompetence or mismanagement.

91. The principal purpose of this reporting requirement is to assist the Exchange in its evaluation of the competence of the sponsor firm. The disciplinary record of a sponsor and/or eligible supervisor may cast doubt on his/her professional conduct and integrity. Although our disclosure requirement and our assessment may overlap with the fit and proper requirements of the SFC, we maintain the view that disclosure to the Exchange is necessary, as any past censorship or alternative regulatory action may raise doubts about the ability of a prospective sponsor or its employees to discharge their responsibilities effectively in respect of advising listing applicants and listed issuers on compliance with the Listing Rules.

92. We nevertheless recognize that the reporting requirement proposed in the Chapter 3A Consultation Paper (which included any company comprising the sponsor, regardless of whether the information is relevant or not) is likely to impose a disproportionate burden. We believe disciplinary action against the sponsor firm and any member of the group of which it forms part (where this may be relevant) is sufficient.

93. We propose that a sponsor firm and any member of the group of which it forms a part (where this may be relevant) should be required to disclose details of any reprimands or disciplinary actions made or taken by a regulatory authority. As many disciplinary actions are disposed of by way of an agreed settlement with the regulators, this would include matters in relation to which a disciplinary sanction or an outcome equivalent to a disciplinary sanction has been imposed irrespective of whether a breach has been proven. A sponsor firm will also need to disclose whether it is the target of any current investigation by a regulatory authority but because of secrecy obligations will not be required to disclose the details until seven days after the relevant person becomes aware that the investigation is completed.

94. A requirement to impose an automatic bar to act if any of such parties has been censured within the five years prior to application would in our view also be unduly harsh as it would not necessarily take into account all the circumstances of the breach. The Exchange will have regard to the circumstances of the sanction or other regulatory action in considering whether to accept that the sponsor has the high standards of competence and integrity necessary to act on behalf of listing applicants and listed companies. A censure or similar sanction will not of itself preclude a sponsor from being named on the list of acceptable sponsors or result in their name being removed from the list. A current suspension or revocation of regulatory status (including where this is self-imposed as a result of a settlement) would automatically preclude a sponsor from being named on the list of acceptable sponsors and would result in the name being removed from the list. A sponsor that has been subject to a suspension of regulatory status in the past (including where this self-imposed as a result of a settlement) that has expired would need to demonstrate that sufficient remedial steps have been taken to address the circumstances that resulted in the suspension to prevent a reoccurrence.

Undertakings to the Exchange

95. Before the Exchange will consider admitting a sponsor firm to the GEM sponsors' list, the current GEM Listing Rules require any prospective sponsor firm to meet the eligibility criteria[15] and undertake to comply with the GEM Listing Rules applicable to sponsors[16]. Pursuant to the undertaking, the Exchange may impose a sanction against the sponsor or any of its employees if there has been a breach or failure to discharge the responsibilities under the GEM Listing Rules[17]. There is no such system under the Main Board Listing Rules.

[15] See Rules 6.12 to 6.19 of the GEM Listing Rules

[16] See Rule 6.20 of the GEM Listing Rules

[17] See Rule 6.67 of the GEM Listing Rules

96. It is proposed that both Main Board and GEM Sponsors be required to declare that the contents of their application to be admitted to the list of acceptable sponsors is true and does not omit any material fact; and to undertake to comply with the relevant Listing Rules applicable to sponsors, including the proposed Code of Conduct for Sponsors and Independent Financial Advisers; and to assist the Exchange with investigations, among other things by producing documents and answering questions fully and truthfully. A breach of the undertaking will be deemed to be a breach of the Listing Rules and will be subject to disciplinary action. We also propose that IFAs be required to provide the same undertakings.

97. Because of the nature of sponsorship and IFA work, the extent to which a sponsor firm and IFA firm comply with their obligations will depend on the standards of conduct of those individuals responsible for supervising sponsorship and IFA work, namely the Eligible Supervisors. The central role of Eligible Supervisors is implicit in the importance we attach to Eligible Supervisors in meeting the criteria to become an acceptable sponsor or IFA. Furthermore, because Eligible Supervisors can freely move between firms, we consider that the Exchange should have a direct relationship with those individuals. Accordingly, Eligible Supervisors will be required to provide the Exchange with a written undertaking in similar terms to that provided by sponsor firms and IFA firms. This will include an obligation to comply with the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. The proposed Code of Conduct for Sponsors and Independent Financial Advisers includes an obligation that the Eligible Supervisors and directors of sponsor firms and IFA firms use their best endeavours to ensure the sponsor firm or IFA firm complies with its obligations under the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers.

APPOINTMENT

98. New applicants (including deemed new listings pursuant to Main Board Listing Rule 14.07(2) and GEM Listing Rule 19.44) are required and will continue to be required to appoint a sponsor to assist them through the application process. The current GEM Listing Rules and Main Board practice provide for firms who are not qualified as sponsors to act as co-sponsors. We are not proposing to continue the concept of co-sponsorship. In most cases we would expect that one sponsor would discharge the sponsor responsibilities in relation to an IPO. For large IPOs in which it is necessary for more than one sponsor to be engaged, we would require that only sponsors on the list of acceptable sponsors be retained and expect that one sponsor be designated as 'primary sponsor'. All sponsors working on the transaction would be responsible for complying with the Code of Conduct for Sponsors and Independent Financial Advisers. The 'primary sponsor' would have the additional responsibility of co-ordinating the due diligence investigations and ensuring sufficient resources are deployed.

99. Listed issuers are required to appoint a sponsor in some circumstances. In relation to connected party transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain from voting, an IFA is required. We will retain this requirement and clarify that an IFA must be a firm either on the list of acceptable Sponsors or list of acceptable IFAs.

100. Under the existing GEM Listing Rules, a new applicant is required to appoint a sponsor pursuant to a contract for a fixed term period following its listing[18]. The existing Main Board Listing Rules have a similar requirement. However, it is only applicable to H-share applicants[19].

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[18] See Rule 6.01 of the GEM Listing Rules. The period during which a sponsor is to be retained is at least the remainder of the financial year during which the listing occurs and the 2 financial years thereafter.

[19] See Rule 19A.05(1) of the Main Board Listing Rules. The period during which a sponsor is to be retained is at least 1 year following the date of listing.

101. The Chapter 3A Consultation Paper proposed that the continuing sponsorship requirement should be extended to all Main Board listing applicants for a term of at least one year following listing. We have considered the merits of this proposal and have concluded that with some modifications such a requirement is necessary.

102. It has been argued that this requirement is unnecessary because Main Board issuers are managed by more experienced businessmen than GEM issuers. Concern has also been expressed that this obligation would create constraints, despite the existence of "Chinese Walls", on the ability of a sponsor to act for other issuers or to deal in the issuers' securities. These constraints already exist as a result of other regulatory requirements and business practice. We do not believe that our requirement imposes any significant addition burden.

103. Whilst the UK Listing Rules do not impose a mandatory continuing sponsorship requirement, there are a number of prescribed situations when sponsors are required to be appointed by issuers to advise them in respect of significant transactions. The relevant transactions include share issues, which require the production of a listing document, major acquisitions, disposals and reconstructions and connected party transactions above a de-minimis level. The UKLA also recommends the appointment of a sponsor as best practice, so that an issuer is able to obtain advice on a continuing basis regarding the application and interpretation of the UK Listing Rules and, in particular, the continuing obligations set out in the UK Listing Rules.

104. The retention of sponsors to provide guidance and advice to directors of new applicants on matters related to the Listing Rules originated from the listing of H-share issuers. It was considered that those directors would not be so familiar with the rules and regulations in Hong Kong, while their sponsor (with its knowledge in this area coupled with the thorough understanding of the applicant) was appropriately qualified to advise. The continuing sponsorship concept was subsequently extended to GEM applicants due to the nature and risk profile of these emerging companies.

105. We acknowledge that Main Board applicants are generally more established due to the trading and performance history requirements for Main Board companies. However, it is evident that in practice many directors of Main Board applicants have little experience of the requirements and application of the Listing Rules or of the responsibilities and obligations of directors of listed issuers.

Accordingly, we believe that having the guidance and advice of a sponsor for a transitional period should be a requirement for new issuers, and that this is also in the interests of the companies concerned.

106. We propose to retain the current time limit in the GEM Listing Rules but otherwise to follow the proposals for the Main Board mentioned below.

107. We propose that new applicants on the Main Board (including deemed new listings) must appoint a sponsor firm as a financial adviser for a period ending on publication of the financial results for the first full financial year after the listing. The issuer will not be obliged to appoint the same sponsor firm who handled their IPO although clearly there are advantages to doing so. During this period the issuer will be obliged to seek, on a timely basis, advice from the sponsor in a number of prescribed circumstances.

108. The Exchange may grant a waiver from this requirement if an applicant can demonstrate that it has:

(a) at least two directors who have more than 5 years experience in the previous 10 years as directors of companies (except investment companies) listed on the relevant Exchange market and unblemished compliance records; and

(b) a full-time compliance officer who reports directly to (or is a member of) the board of directors and who has experience equivalent to that required of an eligible supervisor and an unblemished compliance record.

109. The prescribed circumstances will include the publication of any regulatory announcement; publication of any circular or financial report; where a notifiable transaction (connected or otherwise) is contemplated including share issues and share repurchases and monitoring the use of the proceeds and adherence to the business plans detailed in the prospectus.

110. The Exchange will retain discretion to direct an issuer to appoint a sponsor firm to provide it with advice for any period it specifies. One circumstance in which this discretion is likely to be considered is when an issuer has been held to have breached the Listing Rules, particularly when the breaches are persistent or serious or give rise to concerns about the adequacy of compliance arrangements or the directors' understanding of the Listing Rules and their obligations to comply with the Listing Rules.

111. The idea that the Exchange adopt the United Kingdom approach of requiring a sponsor to be appointed in a wider range of circumstances was also considered. Sponsors in the United Kingdom provide the UKLA with written confirmations in respect of due diligence they are required to undertake in relation to listing particulars (the equivalent of a prospectus) and certain types of circular published by listed issuers. The due diligence covers statements relating to working capital, profit forecasts, the proper extraction of financial information from the issuer's accounting records and (in the case of the production of listing particulars) assurances equivalent to those given for an IPO prospectus.

112. In many of the circumstances stipulated in the United Kingdom, Hong Kong companies will appoint sponsor firms to advise them or will make use of legal advisers with the requisite knowledge. Although they are not obliged to provide explicit assurances in relation to their due diligence, the introduction of requirements similar to those in the United Kingdom would, we believe, improve standards of disclosure. However, it is likely that there would be an increase in costs for issuers. The amount of this increase is difficult to quantify: some companies making extensive use of advisers in such situations may find this to be marginal; for others, who make extensive use of internal expertise, the increase might be significant and even approach the level of advisory costs incurred in producing a prospectus at IPO. There may also be companies who neither make extensive use of external advisors nor have adequate internal expertise; in the case of these companies, the potential benefits for investor protection more obviously outweigh the costs imposed on such issuers.

113. One means by which to address this latter category of companies would be for the Exchange to use its discretion to require the appointment of a sponsor by such companies. A difficulty in this approach would be establishing clear criteria which would allow consistent decision-making. A requirement imposed on all companies would overcome this issue and, on balance, this is our preference. We propose that issuers should appoint sponsors in the case of any application for listing which requires the production of a listing document for registration and that the sponsor should be required to discharge responsibilities equivalent to those applicable in respect of an IPO prospectus. We also propose that the Listing Rules should contain requirements generally applicable to sponsor firms where a sponsor firm gives advice or guidance to an issuer in relation to interpretation or application of the Listing Rules, irrespective of whether or not the Listing Rules require appointment of a sponsor. The sponsor firm will be

obliged to ensure that the issuer is properly guided and advised as to the application or interpretation of the relevant Listing Rules; and must provide that service with due care and skill.

INDEPENDENCE

114. Under the current Model Code for Sponsors and the GEM Listing Rules, sponsors should satisfy themselves that they will be capable of giving the new listing applicant impartial advice before agreeing to accept the role[20]. The current GEM Listing Rules further clarify that a sponsor may not be the legal adviser or be involved in accounting matters (although, subject to certain conditions, it may act as a co-sponsor (applicable to the Main Board as well)) relevant to the new applicant[21].

115. A shareholding in, or business relationship with, a new listing applicant will not necessarily always affect the independence of a sponsor. This was the principle applied in the proposals contained in the Chapter 3A Consultation Paper, which mainly represented a codification of the existing practice of the Main Board and GEM. The Chapter 3A Consultation Paper proposed a list of circumstances that would give rise to concerns about a sponsor's independence. We propose to adopt a similar approach.

116. Market participants have commented that laying down the circumstances may be too inflexible and over-prescriptive and that this should be a matter for the judgement of the sponsor concerned. It is also argued that shareholding and lending relationships can enhance a sponsor's knowledge of a new listing applicant.

117. The SFC Code of Conduct requires the sponsor to ensure that it is capable of giving "impartial advice" before accepting the sponsorship role and that such view is given independently. The UKLA imposes requirements similar to those proposed in the Chapter 3A Consultation Paper except that the maximum permissible shareholding by a sponsor in a new applicant must be less than 3% rather than 5%. No specific thresholds are stipulated otherwise.

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[20] See Model Code for Sponsors, guideline 4 and Rule 6.34 of the GEM Listing Rules

[21] See Rule 6.34 of the GEM Listing Rules

118. We consider independence of a sponsor to be of utmost importance. Investors rely on the information disclosed in a prospectus in arriving at their investment decision and the Exchange also relies on the due diligence performed by sponsors. We believe any material shareholding or relationship may affect independence and, for greater clarity, consider it desirable to list out some specific circumstances that may give rise to concerns about a sponsor's independence. Furthermore, we are of the view that certain thresholds are necessary to provide guidance to market practitioners on the issue of independence. These thresholds are in line with international practice.

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

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

- the fair value of the shareholding referred to above exceeding 15% of the consolidated net tangible assets of the sponsor group;

- a sponsor or any member of the sponsor's group controls the majority of the board of directors of the new applicant;

- a sponsor is controlled by or is under the same control as the new applicant;

- 15% or more of the proceeds raised from an IPO is to be applied to settle debts due to a member of the sponsor's group;

- A significant portion of the listing applicant's operation is funded by the banking facilities provided by a member of the sponsor's group;

- where a director or employee (or their associates) of the sponsor has an interest in or business relationship with the new applicant; and

- where the sponsor or a member of the sponsor's group is the new applicant's auditor or reporting accountant. This requirement mirrors practice set out in codes of ethics for accountants.

120. We do not propose to stipulate any threshold on the banking relationship between a sponsor and a new listing applicant, as ultimately such depends on whether the facilities provided are significant to the new listing applicant. However the nature of a sponsor group's involvement in banking arrangements may be a factor which impacts on independence.

121. In order to avoid any unnecessary delay in processing the transaction, it is advised that the sponsor should consult the Exchange at an early stage where there is any doubt about its independence. We propose to require sponsors to submit a declaration in respect of their independence, including a statement which addresses each specific category of potential conflict, at the beginning of any assignment which requires the appointment of a sponsor.

122. In addition to fulfilling the independence requirement as mentioned in paragraphs 119 to 121 above, we also propose that the Exchange will generally preclude from concluding that an IFA is independent if it has served as a financial adviser to the relevant listed issuer, its subsidiaries or any of its connected persons any significant assignment within two years of appointment. Due to the conflicting interests of connected persons of a listed issuer with the shareholders as a whole in any particular transaction, it is necessary to ensure that a financial adviser will be able to demonstrate its independence before accepting the role of an IFA. The time frame is in line with the SFC's approach to the administration of the Takeover Code, which imposes a similar ban on financial advisers and sponsors from acting as IFAs.

123. We note that the UKLA requires a financial adviser to submit a confirmation of independence when it is appointed by an issuer in relation to a transaction in accordance with the UK Listing Rules. This has also been the practice of the Division in respect of appointment as IFA and accordingly, we propose to codify our requirement.

RESPONSIBILITIES

124. The Exchange's expectation in relation to the role and responsibilities of sponsors follows the experience of other developed markets, principally the United Kingdom, Canada and the United States. When the concept of a "sponsor" was introduced to the Listing Rules, it was modeled on the role of sponsor in the United Kingdom. However the notion of a financial intermediary (usually the lead underwriter) "sponsoring" an issue of securities is originally derived from United States law.

125. In relation to those situations in which issuers of securities on the Exchange are required to retain a sponsor, the Exchange and the SFC have provided some guidance as to the manner in which the sponsorship role has been discharged. These are:

- The Model Code for Sponsors contained in Appendix 9 of the Main Board Listing Rules;
- The GEM Listing Rules; and
- The SFC Code of Conduct.

126. The Main Board Listing Rules currently require a sponsor to satisfy itself, on the basis of available information, that a new listing applicant is suitable for listing. It is also required to be closely involved in the preparation of the listing document and to ensure that all material statements therein have been verified.[22] The Main Board Listing Rules require that sponsors must have agreed to comply with the Model Code, but they do not require sponsors to comply with it. As a consequence, the Exchange cannot currently take disciplinary action against sponsors who choose not to comply with it.

[22] See Model Code for Sponsors, guidelines 1 and 5

127. The existing GEM Listing Rules also set out the responsibilities of sponsors in performing due diligence in relation to a new applicant[23]. In particular, sponsors must submit declarations at the time of submission of the listing application form[24] and prior to issue of the prospectus.[25] In these declarations the sponsor confirms that it has satisfied itself, to the best of its knowledge and belief and having made due and careful enquiries, that the information contained in the listing document is accurate and complete in all material respects and not misleading.

128. The SFC Code of Conduct requires corporate finance advisers, when relying on information from clients, to take all reasonable steps to ensure that information and representations are true, accurate, complete and not misleading, and that no material information or facts have been omitted or withheld. This includes obtaining confirmation from clients.

129. With regard to work by experts or other professionals, the SFC Code of Conduct requires advisers to undertake reasonable checks to assess the relevant experience and expertise of the firm of experts or other professionals and to satisfy themselves that reliance could fairly be placed on their work. This includes satisfying themselves that the qualifications, bases and assumptions for the work of the expert or professional have been made with due care and objectivity, and on a reasonable basis. Such requirements are not applicable to: (i) a valuation report by a property valuer who is a member of a relevant regulatory or professional body; (ii) legal advice rendered by legal advisers; and (iii) an audit of results and accountants' reports by accountants.

130. The Chapter 3A Consultation Paper proposed responsibilities similar to those of GEM but placed 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 new listing application. For example, a sponsor would need to:

- obtain written confirmation from the new applicant that the financial information disclosed in the prospectus had been properly extracted from the accounting records;

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[23] See Rules 6.39 to 6.49 of the GEM Listing Rules

[24] See Appendix 5A of the GEM Listing Rules

[25] See Appendix 7G of the GEM Listing Rules

- carry out its own due diligence review on information provided by directors, co-sponsors or other professional advisers (such as reporting accountants, legal advisers and valuers) and, upon the request of the Exchange, demonstrate the steps taken to ensure the truth, accuracy and completeness of the information provided by the directors and the professional advisers; and

- submit, together with the application form, an in-house due diligence questionnaire on the new applicant signed off by the respective head of compliance and corporate finance departments confirming that the supervisors had discharged all the responsibilities with due care and skill.

131. Comments received from the market in response to the Chapter 3A Consultation Paper revealed a sharp divergence of opinion. Some commentators suggested that the requirement to ensure that all statements are true, accurate and not misleading was beyond the ability of a sponsor. These market commentators maintained that directors of the new applicant alone should be responsible for the contents of the documents issued by a company, as a sponsor would not be aware of any information willfully withheld by the directors. They also considered that it was difficult for sponsors to "verify" the information submitted by other professional parties and judge whether the work of other professionals is accurate, complete or prepared with due care and skill. Furthermore, some commentators could not see how the due diligence questionnaire could provide additional protection. Other commentators, on the other hand, thought that the Exchange could help improve standards by specifying the minimum levels of due diligence and the minimum review procedures required to be conducted by a sponsor or financial adviser.

132. The UK Listing Rules impose requirements similar to those of GEM. Moreover, UK long form reporting practice by reporting accountants, which sponsors require to perform broadly covers the same steps as those proposed in the Chapter 3A Consultation Paper with respect to financial information.

133. Notwithstanding the guidance provided by the Model Code, the GEM Listing Rules and the SFC Code of Conduct, recent experience in Hong Kong suggests that some sponsors to issues of securities on the Exchange are not performing their role to an adequate standard. In a number of cases in which problems have been identified with the accuracy of statements made in IPO prospectuses and

listing application documents, sponsors have sought to disavow responsibility by saying they relied on information provided by directors or officers at face value. In the Exchange's view this does not amount to adequate due diligence in the context of what is recognised as such in most developed markets. In the view of the Exchange, the reluctance of intermediaries to accept additional requirements can no longer be considered an adequate reason to defer the introduction of full international standards.

134. It would appear that there is an expectation gap between the Exchange's view of the responsibilities of sponsors and the manner in which many sponsors are discharging those responsibilities. This has implications for the pricing of sponsor services, because it is more costly and time-consuming to discharge sponsor responsibilities to the standard expected by the Exchange. There are two likely results:

(i) an uneven playing field between those sponsors who meet the standards expected by the Exchange and those who do not, or

(ii) a failure by those sponsors who would otherwise meet the standards expected by the Exchange to do so, because other sponsors have a competitive pricing advantage.

135. In light of the foregoing the Exchange is of the view that it is necessary to clarify its expectations of sponsors. Indeed the comments received from the market in relation to the Chapter 3A Consultation Paper outlined in paragraph 131 above tend to confirm that an expectation gap exists. Nor are the Exchange's expectations unreasonable. They are in line with international standards and reflect the particular needs of the Hong Kong market, bearing in mind particularly the preponderance of new listings from the Mainland.

136. A similar expectation gap exists in relation to IFAs. In reaching a view as to whether the terms of a transaction or arrangement are fair and reasonable and in the interest of the issuers and its shareholders as a whole, IFAs are often too willing to accept at face value information provided by issuer's management or advisers retained by the issuer's management.

137. The approach the Exchange advocates in this Consultation Paper is to revise the Model Code for Sponsors to make compliance with it mandatory under the Listing Rules and to clarify the content of the obligations imposed by the proposed code. The proposed code would apply equally to Main Board and GEM sponsorship. The proposed code will also apply to IFAs. The obligations would be expressed in terms of principles, not as a detailed list of tasks, but with clear guidance on the minimum review procedures that are to be expected. The content and extent of due diligence investigation will always depend on the circumstances; the question of whether due diligence inquiries were adequate in relation to any particular applicant would be a question of judgement. The due diligence obligations of IFAs would be elaborated separately to reflect the different character of IFA work.

Sponsor Due Diligence

138. The UK Financial Services Authority has recently chosen not to define existing due diligence practices in the United Kingdom. The reasons it has given for this decision are that it was thought that the appropriate level of due diligence was well understood, that in practice sponsors tended to set their own rigorous requirements and that it would be restrictive to define these practices. Unfortunately the same cannot be said of the due diligence practices of sponsors in Hong Kong. On the other hand, the TSX has had many years of experience dealing with listing applications (primarily for mining and resource companies) where the major assets of the applicant are outside Canada and often in developing countries. Over time, the TSX has developed a robust sponsorship policy, which describes a series of minimum review procedures and requires the sponsor to clearly document the due diligence performed by it. In much the same way, the Exchange is now of the view that it is necessary to clarify the due diligence standards expected of sponsors in Hong Kong. In doing so, United States case law and SEC guidance is also relevant.

139. In the United States underwriters play a “gate-keeper” role because prospective investors look to the underwriter to pass on the soundness of the securities and the correctness of the registration statement and prospectus. In Hong Kong sponsors fulfil that gate-keeper role.

140. In the United States, "due diligence" encompasses both an underwriter's affirmative responsibilities and the defence it may assert to avoid civil liability for claims brought under sections 11 and 12 of the Securities Act of 1933. Section 11 precludes liability where the underwriter believed, after "reasonable investigation" that no violation existed. Section 12 precludes liability where the underwriter, having exercised "reasonable care" did not or could not have known of the violation. The adequacy of an underwriter's due diligence efforts is determined by the standard of reasonableness that is required of a prudent man in the management of his own property. United States courts have also pointed out that the question of what is "reasonable due diligence" depends on the specific factual context. Due diligence in the context of an IPO will be subjected to a greater degree of scrutiny than other offerings because such securities have never been publicly traded and information about the issuer is often not readily available.

141. US case law is helpful in illustrating the sorts of situation in which due diligence is not considered adequate. It is clear from these cases that an underwriter's investigation does not end with the receipt of information from management, but contemplates that the underwriter verify independently the information it has been given. The underwriter or its agents cannot simply accept at face value documents produced by the issuer and statements made by the issuer. When the underwriter or its agent possess information that may indicate potential problems with the offering materials, its normal due diligence procedures are inadequate and require more concrete verification of management representations and projections.

142. Underwriters are also required to examine the issuer's current financial health and its future financial prospects as part of their due diligence investigation. This includes:

- Reviewing the issuer's financial statements, including referring to the analysis and opinions of the issuer's independent auditor to determine whether potential problem areas were uncovered during the audit; and

- Looking at general financial issues including profit and revenue, budget concerns and internal audit controls.

143. The sorts of measure that United States courts have considered as contributing to a determination that due diligence was adequate have included:

- working closely with the issuer's accountants and lawyers, in particular reviewing financial statements with auditors and obtaining comfort letters from these auditors;
- repeatedly interviewing the issuer's management and employees;
- conducting site visits of factories and other key physical assets;
- obtaining written representations from the issuer and its selling shareholders that the information in the registration document is accurate and does not contain any material omissions; and
- extensively questioning third parties such as the issuer's customers, suppliers and distributors.

144. The SEC recognised that the extent of due diligence investigations expected of an underwriter depends on the context in which due diligence occurs and has cited the following factors as being relevant:

- the type of issuer, security and underwriting arrangement;
- whether or not the person conducting the investigation had some relationship with the issuer other than as an underwriter;
- reasonable reliance on officers and employees of the issuer and others who should have knowledge of the particular facts relied upon; and
- the availability of information about the issuer.

145. The reasonableness required of underwriters' due diligence investigations also depends on whether those investigations relate to "expertised" sections (that is those sections of a disclosure document prepared by a third party expert or professional – e.g. unaudited financial statements are not "expertised" sections whereas an audited report on financial statements would be regarded as "expertised" sections) or "non-expertised" sections of the disclosure document. The test for "non-expertised" sections is whether the underwriter had "reasonable

grounds to believe and did believe…that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading." This imposes a duty to positively satisfy itself of the truth and completeness of non-expertised statements. The test for "expertised" sections is whether after "reasonable investigations" they had "reasonable grounds not to believe and did not believe …that the statements in the "expertised" section were untrue or that they omitted a material fact." This imposes a reverse duty on the underwriter to satisfy itself that "expertised" sections are not untrue or incomplete. In this respect the issue is "reasonable reliance" rather than "reasonable investigation." The issue is whether, on the face of the information or opinion contained in the "expertised" section of the document and taking into account the underwriter's knowledge derived from its other due diligence inquiries, it can reasonably rely on the contents of the "expertised" section of the report. The sponsor would not be required or expected to duplicate the work of the expert or second-guess the expert's professional opinion or judgement.

Proposed Rule Changes

146. It is proposed that the Main Board and GEM Listing Rules be amended to require sponsors to conduct reasonable investigations to satisfy themselves that:

- the new applicant is suitable for listing, the new applicant's directors appreciate the nature of their responsibilities and the new applicant and its directors can be expected to honour their obligations under the Listing Rules and the Listing Agreement (refer to Main Board Listing Rule 3.04 and GEM Listing Rule 6.47);

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

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

For this purpose, the Exchange proposes that any part of a prospectus purporting to be made on the authority of an expert or purporting to be a copy of or an extract from a report, opinion or statement of an expert, shall be called the "expert sections". Other parts of the prospectus are the "non expert sections".

147. It is proposed that the Main Board and GEM Listing Rules be amended to require IFAs:

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

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

The Code of Conduct for Sponsors and Independent Financial Advisers

148. The Listing Rules will require that sponsors and their directors and staff comply with the proposed Code of Conduct for Sponsors and Independent Financial Advisers. A failure to comply with the proposed Code of Conduct for Sponsors and Independent Financial Advisers may result in the Exchange commencing disciplinary action against the sponsor, an eligible supervisor or a director or staff member of a sponsor. The proposed Code of Conduct for Sponsors and Independent Financial Advisers will mirror the SFC Code of Conduct but will contain additional obligations of direct application to sponsors.

149. The Code of Conduct for Sponsors and Independent Financial Advisers will apply to sponsors advising:

- new applicants for listing in relation to the listing application and the preparation of the prospectus;

- listed issuers acquiring assets in which the transaction is classified as a very substantial acquisition and treated as a new applicant; and

- issuers after the listing of the issuer's securities in circumstances in which the issuer is required by the Listing Rules or the Exchange to retain a sponsor as an adviser or when the issuer voluntarily retains a sponsor as an adviser in relation to compliance with the Listing Rules. The former circumstances would include the continued sponsorship period mentioned in paragraph 106 and 107 above and any special circumstances in which the Exchange required an issuer to retain a sponsor as an adviser.

The proposed Code of Conduct for Sponsors and Independent Financial Advisers will also apply to IFAs and will contain additional independence requirements in order for sponsors and financial advisers to act as IFAs. The proposed Code of Conduct for Sponsors and Independent Financial Advisers will also clarify the due diligence obligations of IFAs.

150. The proposed Code of Conduct for Sponsors and Independent Financial Advisers will apply to sponsor firms, IFA firms, eligible supervisors and other directors and staff of sponsor firms or IFA firms. Some of the obligations will apply only to sponsor firms and IFA firms, some obligations will apply to sponsor firms, IFA firms, and their eligible supervisors and some obligations will apply only to eligible supervisors and directors of sponsor firms or IFA firms. In the latter case, the proposed Code of Conduct for Sponsors and Independent Financial Advisers will impose an obligation on eligible supervisors and directors of sponsor firms or IFA firms to use reasonable endeavours to ensure sponsor firms or IFA firms comply with their obligations under the proposed Code of Conduct for Sponsors and Independent Financial Advisers.

151. The proposed Code of Conduct for Sponsors and Independent Financial Advisers will illustrate the general obligations of due diligence proposed to be included in the Listing Rules refer to paragraph 146 above by reference to non-exhaustive descriptions of the subject matter and extent of due diligence. In particular the proposed code will clarify that:

- sponsors must make site visits and other appropriate enquiries;

- in relation to the "non-expert sections" of a disclosure document or listing application the sponsor cannot simply rely on the statements of directors and senior management but must conduct its own investigations;

- in relation to the "expert sections" of a disclosure document or listing application the sponsor must determine whether, in light of its knowledge of the application/issuer and the scope of work, methodology and assumptions employed, it can reasonably rely on the truth and completeness of the statements contained therein; and

- in the event that problems are or should reasonably have been identified in relation to statements contained in either the "expert sections" or "non-expert sections" of the disclosure document or listing application, the sponsor will be under an obligation to conduct more detailed, extensive and intrusive investigations to ensure the accuracy and completeness of the statements in question.

152. A draft of the proposed Code of Conduct for Sponsors and Independent Financial Advisers is attached to this Consultation Paper as Annex 2.

Declaration by sponsors and lead underwriters in listing documents

153. The Companies Ordinance provides that directors and other persons who "authorise" the issue of a prospectus are liable to pay compensation in relation to untrue statements. By signing a prospectus, the sponsor (or lead underwriter) would be held to be "authorising" its issue.

154. In the United States, lead underwriters (the nearest equivalent to sponsors) are required to sign the prospectus. Generally, there are only 1 to 3 lead underwriters and the others act as sub-underwriters. The latter do not sign the prospectus. Securities law requires that an underwriter in a direct contractual relationship with the listed issuer must sign a certificate which states that, to the best of his knowledge, information and belief, the information provided constitutes full, true and plain disclosure of all material facts relating to the securities offered, as required by the relevant Act.

155. In the United Kingdom, sponsors sign and take responsibility for certain parts of the prospectus and accountants (or appraisers, where relevant) for other parts. However, under the FSA's market abuse rules, sponsors can be disciplined in relation to any part of the listing documents which proves to be false or misleading, if they are held to share responsibility.

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

157. There may be a concern that this requirement extends the liability of sponsors and underwriters under the Companies Ordinance. It is arguable whether this is in fact the case, or whether it represents an extension of the current disciplinary regime for sponsors. On a restricted interpretation, the Companies Ordinance does not presently appear to place clear liability on intermediaries including sponsors, other intermediaries who do not issue reports for inclusion in the listing document and lawyers involved in the preparation of the documentation.

158. However, as sponsors are closely involved in the preparation of the listing document and provide the Exchange with explicit confirmations regarding the listing document, there is an argument that liability for prospectus misstatements already extends to sponsors and underwriters as promoters of the company. This argument is largely untested. The Exchange believes that a clear statement of the sponsor's responsibility with respect to the listing document will be helpful in focussing the efforts of sponsors on high quality and thorough due diligence.

159. Notwithstanding that sponsors may already be liable for prospectus misstatements, the proposed declaration and proposed Code of Conduct for Sponsors and Independent Financial Advisers would set new, and increased, standards to be applied by the court and the Market Misconduct Tribunal when

considering claims for civil liability on the part of sponsors and lead underwriters for false or misleading information in prospectuses, and whether market abuse has occurred, respectively. The same comment would apply to the SFC's investigation of whether sponsors and lead underwriters have been guilty of misconduct or are not fit and proper. Fundamentally, however, the requirements for establishing liability would not change. Criminal liability would only be established if recklessness was established, and in practice we consider that this would be more difficult if the sponsor and lead underwriters have conducted more due diligence, even where that due diligence proves to be inadequate.

160. Generally, additional due diligence work performed should provide additional protection for lead underwriters and sponsors and make it a more challenging task for investors and regulators in borderline cases to demonstrate successfully that there has been a failure to meet requisite standards. In practice, the new standards contained in the proposed declaration may not necessarily result in an increase in claims being made where problems arise, absent first regulatory investigations and the imposition of disciplinary sanctions.

Impact on due diligence costs

161. In putting forward these proposals we are mindful of the need to balance the desirability of maintaining the competitive position of Hong Kong with improvements which will contribute to market integrity and investor confidence. We believe these proposals may strike the appropriate balance.

162. It has been suggested by some market participants that the introduction of standards of due diligence to close the "expectation gap" accompanied by prominent disclosure of the sponsor's role in performing due diligence on the prospectus both distracts from the responsibilities which should properly be borne by the directors and will lead to increased professional fees for new applicant companies.

163. The increase in professional fees would comprise an element of cost incurred in meeting the new standards and an element reflecting an individual firm's need to manage the risks they perceive to be associated with prominent disclosure of their due diligence role. The potential increase in costs cannot be easily quantified as any increase will depend on both the circumstances of the applicant and the approach to due diligence currently taken by the sponsor concerned. Nor for that matter can the potential benefits to investors and the reputation of the market of these measures be quantified.

164. For prospective issuers raising funds through global offerings we do not believe that our requirements will give rise to any significant additional costs. Our proposed standards do not extend beyond those applicable for offerings into the United States and United Kingdom, the two most significant international markets.

165. The potential increase in costs for other prospective issuers we believe, on balance, to be acceptable as the potential benefits for investor protection and the integrity of the Hong Kong markets provide adequate incentives against which to balance the potential costs imposed on issuers.

REPORTING OBLIGATIONS AND MONITORING

166. Our experience in the administration and operation of the GEM sponsors' list shows that significant time and resources are required to process applications and monitor the on-going eligibility of admitted sponsors through the annual review process. Significant inconvenience also arises when sponsor's experience changes in qualified personnel, which require notification to, and approval from, the Exchange's GEM Listing Committee and, in certain circumstances, temporary suspension of sponsorship activities.

167. Under the SFC's licensing requirements, annual returns must be filed and any changes in information provided by a licensed advisory firm or its relevant professional staff must be reported in writing within 7 days. A similar reporting requirement is imposed by UKLA.

168. In order to streamline the administration of the sponsor and IFA regime the Exchange proposes that all first instance decisions in relation to eligibility on application; on-going eligibility and independence of a sponsor or IFA should be made by the Listing Division and subject to review, if necessary, by the Listing Committee. We also propose to replace the requirement for an annual review with a certification process and a targeted programme of monitoring.

169. We will require sponsor firms and IFA firms and their eligible supervisors to submit annual confirmations that they remain eligible to act in such capacity. In addition, they will be required to report to the Exchange as soon as they become aware they no longer satisfy the eligibility criteria set out in the Listing Rules or any information provided by them in connection with their application or continued inclusion on the list of Sponsors or list of IFAs has changed. The

Exchange may also conduct a specific review in relation to the continued inclusion of the sponsor firm or the IFA firm (or any of its employees) if it becomes aware or has reason to believe that the suitability of the firm/individual may be in question.

170. To clarify how the Exchange will monitor performance standards and whether a sponsor or IFA remains in compliance with the Listing Rules applicable to it, we propose to provide guidance on the approach we will use, which is similar to that adopted by the UKLA.

The monitoring tools we will use will vary according to circumstances and may include one or more of the following:

- Complaints;
- Desk based reviews of transactions;
- Reviews of referrals;
- Liaison with other agencies, professional or regulatory bodies;
- Meetings with management and other representatives from a sponsor firm or IFA firm;
- On-site visits after prior notification;
- Reviews of notifications and confirmations from sponsors or IFAs; and
- Reviews of past services provided, and documentation produced, pursuant to the listing rules by a sponsor or IFA.

COMPLIANCE AND SANCTIONS

171. Under the existing Listing Rules, the Exchange may refer any breaches of responsibilities by a professional adviser of a listed issuer, a sponsor of a listed issuer or a new applicant, or any of their members of staff to the Listing Committee for action[26].

[26] See Rule 2A.10 of the Main Board Listing Rules and Rules 6.67 and 6.68 of the GEM Listing Rules

172. The rationale for imposing penalties on sponsors or financial advisers or any of their members of staff is to promote high standards of conduct and ensure that regulatory standards are being upheld. In the same way that the Exchange, as the regulatory body that principally relies on sponsors, will have criteria to determine which firms and eligible supervisors should do sponsorship work, the Exchange should have the ability, by resort to disciplinary action, to exclude firms and individuals from doing sponsorship work.

173. Under the existing Listing Rules, if the Listing Committee determines that there has been a breach of the Listing Rules by a sponsor, a financial adviser or any member of their staff, it may take disciplinary action against any of them. A list of sanctions is set out in the Listing Rules. In particular, the Listing Committee may bar a sponsor or financial adviser or any individual employed by the professional adviser from engaging in advisory services for a stated period of time[27]. In practice this has not occurred because of the limited nature of the obligations imposed on sponsors under the Listing Rules.

174. The Chapter 3A Consultation Paper proposed similar sanctions but specified that the party in question would not be allowed to be involved in any sponsorship activities or advisory activities for a period of one year from the date of sanction.

175. There were comments from the market that the "cold shouldering" of such parties is too harsh and that adequate regard should be made to the nature of the breach in setting the sanction. In addition, where the Exchange sanctions an adviser, the lapse in compliance may well lead to penalties and criminal and civil sanctions under the SFO.

176. If there is a breach of any requirements of the SFC Code of Conduct by a corporate finance adviser, such breach may adversely reflect on its fitness and properness, and may result in disciplinary or other actions by the SFC. However, because the SFC Code of Conduct does not include specific obligations tailored to the work of sponsors, the SFC has seldom taken disciplinary action against sponsors for failing to perform proper due diligence.

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[27] See Rules 2A.09 and 2A.10 of the Main Board Listing Rules and Rules 6.67 and 6.68 of the GEM Listing Rules

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

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

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

179. In addition, the Exchange will have a range of other actions including warning letters and, when appropriate, the ability to require a sponsor or IFA to take appropriate remedial action. We propose that these sanctions against sponsors and IFAs and their eligible supervisors, directors and staff be incorporated into the disciplinary processes in the current Chapter 2A of the Main Board Listing Rules and Chapter 3 of the GEM Listing Rules.

Demerit point system

180. The idea that sanctions should be accompanied by a system of "demerit points" (similar to points on a driving licence) has been considered by the Exchange. It has some attractions, since it would provide a graded series of penalties and can serve to correct misconduct without requiring costly proceedings. Such a system has been implemented by the CSRC on underwriters in the PRC. However, there are a number of serious drawbacks to this approach in Hong Kong:

(a) Driving offences, notably speeding (which accounts for the majority of points awarded) are easily defined and measurable. Failures to discharge responsibilities in a professional and competent manner are much more difficult to define. Setting the "triggers" for the imposition of points, and the number of points for particular offences, would be very contentious.

(b) The requirements of due process probably mean that any award of points would have to be subject to a formal disciplinary proceeding and an appeal procedure – which would be likely to make the system unwieldy and unacceptably expensive to administer.

(c) The seriousness attached to a breach of the rules is related to the intent of the party concerned and other circumstances of the particular case. This is an area where judgement has to be exercised. It is impossible to cater for this in a mechanical points system.

181. In any case, a points system is a means to an end, not an end in itself. The absence of a points system does not lessen the effectiveness of the other sanctions.

Resignation/Termination of Sponsors and IFAs

182. A sponsor must have the right to resign (e.g. if there is a dispute over his fees or these are not paid), in which case the issuer should be required to appoint a new sponsor within 3 months. An IFA must also have the right to resign if it is not able to discharge its role and responsibilities (e.g. due to the company not cooperating or providing enough information). The sponsor or the IFA should report to the Exchange the reasons for its resignation. By the same token, listed issuers should be able to terminate the sponsorship agreement or IFA agreement if they consider that the sponsor's work or IFA's work is of an unacceptable standard. The reasons for termination would have to be disclosed to the Exchange.

Promulgation and Transitional Arrangements

183. In the event that after reviewing the results of the consultation, the Exchange and the SFC decide to implement some or all of the proposals then the Exchange will draft the necessary rule amendments and obtain authorisation from the relevant Exchange Boards and Committees to promulgate those rule amendments. This process is likely to take approximately 3 to 4 months.

184. We propose that some rule amendments, if proceeded with, will come into effect immediately on promulgation and others will come into effect at the conclusion of a transitional period.

185. We propose that the requirements that only firms on the list of acceptable sponsors be eligible to do sponsor work and that only firms on the list of acceptable sponsors or on the list of acceptable IFAs be eligible to do IFA work, if proceeded with, be subject to the one-year transitional period. This will allow firms time to identify potential eligible supervisors and to ensure that those individuals have satisfied all relevant requirements. We propose that all other rule changes, including the requirement that sponsors sign the prospectus, that IFAs sign a due diligence declaration in their report and that sponsors and IFAs comply with the proposed Code of Conduct for Sponsors and Independent Financial Advisers if they are proceeded with, will commence as soon as they are promulgated.

Impact Analysis

186. We have conducted an initial impact analysis to seek to determine how many existing GEM sponsors would not meet the criteria to be admitted on the list of acceptable sponsors. We do not have sufficient information to do a similar exercise for IFAs and we only have limited information in relation to Main Board sponsors.

187. As regards the four eligible supervisor requirements, our initial analysis based on information at our disposal but which may be out of date is that while most existing GEM principal and assistant supervisors will meet the requirements to be eligible supervisors, only 28 of the 56 firms (50%) that are currently GEM Sponsors would meet the four eligible supervisor criteria but that 43 of the 56 firms (77%) have 3 staff members who would meet the eligible supervisor requirements. To address this, we are contemplating a further transitional measure

whereby for existing GEM sponsor firms to be admitted to the list of acceptable sponsors at the conclusion of the one-year transitional period, they are required to have 3 eligible supervisors and meet the other requirements and that their continuation on the list at the end of the second year after the new rules come into effect would be subject to them satisfying the 4 eligible supervisor requirement. We expect that these proposed transitional arrangements (one year plus one year) should give existing GEM sponsors who intend continuing to do sponsorship work in the future sufficient time to meet the 4 eligible supervisors requirement. Even those firms who currently have less than 3 persons who satisfy the eligible supervisor requirement could use the initial one-year transitional period to identify 3 eligible supervisors and use the additional year to identify a fourth.

188. As regards the HK$10 million minimum paid up capital and NTA requirements, all existing GEM sponsors meet those requirements and of the 15 firms that have acted as Main Board sponsors but are not GEM sponsors, 9 meet both requirements, 2 meet the NTA requirement but not the minimum paid up capital requirement, 3 meet the minimum paid up capital requirement but not the NTA requirement and 1 meets neither requirement. We would expect that all 6 firms that do not currently meet one or both requirements would be able to satisfy those requirements within the one-year transitional period.

189. As we have been unable to do an impact assessment in relation to IFAs and as our preliminary analysis in relation to GEM and Main Board sponsors is incomplete and based on potentially out of date information, we would ask all firms who currently perform those roles to provide detailed responses to question 18. As the proposed transitional arrangements are tentative at this stage, we would also welcome comments and suggestions about alternative ways to address the issues arising from our impact analysis. In the light of responses to this consultation, the actual timing for implementation of the individual proposals are to be decided taking into account the likely market impact.

PART C
OTHER PROFESSIONAL ADVISERS

GENERAL

190. Other professional advisers include legal advisers, auditors, reporting accountants and any experts who value assets in relation to the corporate transactions of listed companies.

191. The existing Listing Rules establish the qualifications and practice standards to which auditors, reporting accountants and property valuers must adhere. Similar requirements do not exist for appraisers and valuers engaged in the appraisal of assets other than property (real estate).

192. Section 38 of the Companies Ordinance mandates the minimum required contents of a prospectus by reference to the Third Schedule of the Ordinance. The reports by professionals required as a minimum by the Third Schedule are those of the reporting accountants and property valuers. The relevant experts authorise the publication of their reports in the prospectus and take responsibility for the accuracy and reliability of that disclosure. In addition, the Exchange and sponsors place reliance on information and explanations provided by such experts during the preparation and review of a new applicant's application for listing, for example, legal opinions as to whether the issuer and its operations comply with all relevant applicable law and regulations.

193. Concerns expressed about the existence of an "expectation gap" in relation to the responsibilities of professional advisers extend beyond sponsors to the roles of some professional advisers. There are a number of legislative and regulatory proposals currently under consideration by the Administration, which will affect the standards, and responsibilities of the main professionals. The question of whether statutory liability of financial intermediaries will be extended under the Companies Ordinance has already been mentioned and is a significant proposal. In addition, the proposals set out in Part B in respect of the responsibilities of sponsors are relevant in respect of the role a sponsor will play in selecting, evaluating and reviewing the work of the other professional advisers involved in a listing matter.

194. We describe below the Exchange's involvement in a number of initiatives, in particular those relating to the regulation of reporting accountants, property valuers and non-property valuers. We do not, in this consultation document, propose changes to the Listing Rules affecting other professional advisers involved in the listing process and the provision of services to listed issuers. However, our further work described below may lead to a number of proposals for rule amendments.

LEGAL ADVISERS

195. The role of legal advisers is not considered in this Consultation Paper. The responsibilities of legal advisers are established by the Legal Practitioners Ordinance, the Law Society of Hong Kong and its Guide to Professional Conduct. There also exists a Memorandum of Understanding between HKEx and the Law Society which provides a framework for dealing with any failure by legal practitioners to meet their responsibilities in relation to listing matters.

HONG KONG SOCIETY OF ACCOUNTANTS

196. Professional accountants are regulated by the Hong Kong Society of Accountants ("HKSA") under powers granted to the HKSA by the Professional Accountants Ordinance. Professional accountants mainly act as "reporting accountants" or as auditors of listed issuers. Reporting accountants are engaged by new applicants and listed issuers (effectively, the directors) to produce a financial report and/or a report on the directors' profit forecast for incorporation in a prospectus, information memorandum or other document issued by the company in connection with an IPO or a significant transaction.

197. Rule 4.03 of the Main Board Listing Rules and Rule 7.03 of the GEM Listing Rules require that a reporting accountant be a member of the HKSA. The HKSA prescribes the professional standards relating to ethics, accounting and financial reporting and auditing for reporting accountants.

198. Auditors are appointed by shareholders under the Companies Ordinance or equivalent overseas law, and report to the shareholders on the financial reports prepared by the directors. The duties of the auditor are set out in extensive common law precedents and the professional standards established and enforced by the HKSA or the equivalent standards of overseas professional bodies for foreign auditors.

199. The HKSA's Professional Standards Monitoring Committee monitors the quality of audited financial statements of listed companies for compliance with accounting and reporting requirements. The Listing Committee, on the basis of a recommendation from the Listing Division, may make a complaint to the HKSA in relation to sub-standard audit work.

200. In the light of the major corporate failures of Enron and Worldcom in the United States and developments in other jurisdictions in response to those failures, the Administration and HKSA are reviewing current arrangements and standards in a number of areas related to supervision of the accountancy profession. There are five areas in which developments are taking place which we note below. The Exchange has a significant interest in the development of measures to promote greater investor confidence in standards of financial reporting and will contribute to the Administration's initiatives, where appropriate.

201. Two of the issues being considered by the Administration relate to structural features in the current regulatory arrangements and a desire to achieve a greater degree of independence in those arrangements as they impact on work performed for new applicant and listed issuers. The first is the establishment of independent oversight arrangements for professional standards and disciplinary matters within HKSA. The second is the proposed establishment of a statutory financial reporting review panel which would monitor the standards of financial reporting by listed issuers.

202. In addition, the HKSA has other work in hand. The HKSA has established specific accounting and auditing standards on the responsibilities of reporting accountants in prospectuses and profit forecasts. These standards were based on the equivalent United Kingdom standards at the time they were published. HKSA is in the process of updating the standards to take account of further developments in the United Kingdom and other international standards and practice. The Exchange and SFC are contributing to this work by providing the regulators' perspective on the issues arising.

203. HKSA is also revising its Code of Ethics to take account of revised international standards, including but not limited to the IFAC "Code of Ethics for Professional Accountants". HKSA has published an exposure draft of the proposed code for comment. The comment period ended on 15 December 2002.

204. Finally the Exchange is negotiating a Memoranda of Understanding ("MoU") with HKSA which will provide a formal gateway through which the Exchange may refer concerns about the conduct of accountants engaged in stock exchange listing work.

HONG KONG INSTITUTE OF SURVEYORS

205. The Hong Kong Institute of Surveyors ("HKIS"), which is in consultation with the Exchange, is developing its own list of specialists who will be qualified to perform valuations for stock exchange listing purposes. The criteria proposed and accompanying guidance will establish the qualifications, experience and competence needed to perform such work.

206. The Exchange believes that the successful implementation of these proposals and the associated disciplinary infrastructure will reinforce the role of the HKIS for property valuations and may provide an appropriate framework to promote high standards. The Exchange is working with HKIS in the development of its proposals and, subject to satisfactory progress, will negotiate a MoU with HKIS to provide a formal gateway through which the Exchange may refer concerns about the conduct of HKIS members engaged in listing work.

207. The Exchange will also consider amendments to paragraph 5.05 and 5.08(2) of the Main Board Listing Rules and their GEM equivalents to reflect the dissolution of the Hong Kong branch of the Royal Institution of Chartered Surveyors and, if necessary, to introduce measures to buttress the new standards proposed by HKIS.

NON-PROPERTY VALUERS

208. The absence of a professional body for non-property valuers presents a greater range of issues for the Exchange and requires a different approach in the short term to deal with concerns about the quality of reporting.

209. A longer-term aspiration of some individuals involved in the production of valuation and appraisal reports on non-property assets with whom the Exchange has held discussions is the establishment of a professional body for Hong Kong with power to establish, monitor and enforce professional standards relating to ethics, competency, conduct of work and the form and content of reports for the public.

210. This initiative is in its infancy, and whilst the Exchange encourages this development, in the short-term we believe that other measures may need to be considered to improve standards and transparency in this area of reporting.

211. The Exchange proposes to study the regulatory standards for valuation of non-property assets in other jurisdictions and to consider to what extent these can be readily adopted in Hong Kong. In particular we will look at the work of the Appraisals Standards Board in the United States which has promulgated a set of Uniform Standards of Professional Appraisal Practice ("USPAP"). USPAP represents the generally accepted and recognised standards of appraisal practice in the United States and its standards are enforced by various state and federal regulators.

212. We will also consider the extent to which enhanced disclosure in published valuation reports may contribute to higher standards of disclosure.

213. Our proposals for further consideration and analysis include disclosures of statements in respect of the following matters:

- the qualifications, independence and competence of valuers;
- whether or not the work performed has been in accordance with established professional standards and identification of those standards and any material departure from them;
- explanations about the bases, methods and assumptions used in the valuation and the rationale for those bases, methods and assumptions;
- the nature of evidence used in support of conclusions drawn in the report; and
- the comparative data, used with explanations supporting the rationale for those comparisons and commentary on the availability and relevance of other comparative data.

ANNEX 1

SUMMARY OF OUR MAIN RECOMMENDATIONS AS COMPARED TO THE EXISTING MAIN BOARD RULES, GEM RULES, AND THE UK LISTING AUTHORITY LISTING RULES AND GUIDANCE MANUAL (WITH NOTES DESCRIBING THE REGULATORY REGIMES IN THE UNITED STATES, AUSTRALIA AND CANADA)

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
Eligibility criteria			
• List of acceptable sponsors.	• No current requirements. • As a matter of practice, in order for a financial adviser to be eligible to act as a sole sponsor in a new listing application on the Main Board, it must have previously acted as a co-sponsor in at least 2 successful listing applications. Furthermore, in order for a financial adviser to be eligible to act as a co-sponsor in a new listing application on the Main Board, it must have previously acted as a financial adviser in at least 2 corporate finance advisory transactions.	• Prospective sponsors must be approved by the Exchange for such purposes and admitted to the list of "Sponsors" maintained by the Exchange. • Financial advisers (and sponsors) must be properly licenced by the SFC for the purpose of provision of corporate finance advice.	• Sponsor regime is similar to that in the GEM Listing Rules. UK Listing Authority maintains a Register of sponsors. • Financial advisers (and sponsors) must be authorised by the FSA or regulated by a designated professional body for the purpose of provision of investment advice.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
	• Financial advisers (and sponsors) must be properly licenced by the SFC for the purpose of provision of corporate finance advice.		
• List of acceptable IFAs.	• No current requirements.	• No current requirements.	• No current requirements.
• List of unacceptable individuals.	• No current requirements.	• No current requirements.	• No current requirements.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Each of the firm and the individuals seeking to be admitted to the list must sign an undertaking to discharge its responsibilities under the Listing Rules (including the Code of Conduct for Sponsors and Independent Financial Advisers) and co-operate with the Exchange.	• No current requirements.	• Prospective sponsors seeking to be admitted to the list must complete an undertaking to discharge its responsibilities under the GEM Listing Rules and to co-operate with the Exchange.	• Application forms are submitted by the firm and individuals who are to be eligible employees. As the listing rules applicable to sponsors have statutory backing (FSMA 2000) and the rules require sponsors (but not eligible employees) to comply with all relevant rules a formal undertaking is not required. However prior to 1 December 2001 an undertaking to the UK Listing Authority had been required.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Sponsors are required to have a minimum of 4 senior staff that satisfy the criteria for Eligible Supervisors.	• No current requirements.	• A minimum of 2 full-time executive directors that satisfy the criteria for Principal Supervisors. • A minimum of 2 full-time staff members that satisfy the criteria for Assistant Supervisors.	• Four "eligible employees" at all times.
• IFAs are required to have a minimum of 2 senior staff that satisfy the criteria for Eligible Supervisors.	• No current requirements.	• No current requirements.	• No current requirements.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Each Eligible Supervisor must have at least 4-year relevant corporate finance experience and during that period played a substantive role in at least 3 significant transactions, at least one of which must have been in Hong Kong, at least one of which must be an IPO and at least one of which must have been within the previous two years. These will be continuing requirements.	• No current requirements.	• Each Principal Supervisor must have, over the 5-year period prior to date of declaration, played a substantial role on 2 completed IPOs on the Exchange and other relevant corporate finance experience derived from companies listed on the Exchange. Overseas experience is accepted provided a substantial part has been derived from companies listed on the Exchange.	• Each eligible employee must have over the previous 36 months, given advice in connection with at least 3 significant transactions. • Each eligible employee must have provided advice in connection with a significant transaction in the last 12 months. • UKLA generally accept IPOs, Class 1 transactions, related party circulars and the preparation of listing documents for further issues of shares as significant transactions.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• "Significant transactions" are defined as (i) IPOs; (ii) very substantial acquisitions or disposals (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iii) major transactions (or their equivalent under the rules applicable to listing on other recognised stock exchanges); (iv) connected and major transactions (or their equivalent under the rules applicable to listing on other recognised stock		• Each Assistant Supervisor must have, over the 3-year period prior to date of declaration, relevant corporate finance experience derived from companies listed on the Exchange. Overseas experience is accepted provided a substantial part has been derived from companies listed on the Exchange.	

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
exchanges); (v) a rights issue or open offer by a listed company (or their equivalent under the rules applicable to listing on other recognised stock exchanges); and (vi) takeovers subject to the Takeover Code (or its equivalent in other recognised jurisdictions). Guidance will be provided to clarify that transactions involving the production of an exempt listing document and the listing of investment companies will not be regarded as significant transactions.		• "Corporate finance experience" is defined as experience derived from providing advice on matters such as notifiable transactions, connected transactions, mergers and acquisitions, takeovers subject to the Takeover Code and/or other appropriate and significant transactions or equity-fund raising exercises.	

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• IFA Eligible Supervisors would be subject to the same qualification and experience criteria as Sponsor Eligible Supervisors except the requirement to have done one IPO transaction. • Any individual may perform sponsor or IFA work provided they are licensed/registered under the SFO, the person is an eligible supervisor or works under the supervision of an eligible supervisor and the person is not on the list of unacceptable individuals.	• No current requirements.	• No current requirements.	• No current requirements.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Sponsors are required to have total paid up capital and/or non distributable reserves of not less than HK$10 million represented by unencumbered assets and net tangible assets after minority interest of not less than HK$10 million, or guarantee from a company within the sponsor group or an authorized institution of not less than HK$10 million.	• No current requirements. However, pursuant to the Model Code for Sponsors, a sponsor should satisfy itself that it has adequate resources to fulfil the role expected of a sponsor.	• Total paid up capital and/or non distributable reserves of not less than HK$10 million represented by unencumbered assets and net tangible assets after minority interest of not less than HK$10 million, or guarantee from a company within the sponsor group or an authorized institution of not less than HK$10 million.	• No current requirements in the UK Listing Rules.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Guidance on sponsor independence. The following would give rise to concerns on a sponsor's independence: 1. Holding of 5% or more of the issued share capital of the new applicant; 2. The fair value of the shareholding referred to above exceeding 15% of the consolidated net tangible assets of the sponsor group; 3. Controlling the majority of the board of the new applicant;	• No current requirements. However, pursuant to the Model Code for Sponsors, a sponsor must satisfy himself that he will be capable of giving a new listing applicant impartial advice. • A sponsor may not be involved in accounting matters (although, subject to certain conditions, it may act as a co-sponsor). • As an internal guideline, a sponsor may own securities in the issuer and the maximum limit is 5%.	• No sponsor may act for any new applicant or continue to act for any listed issuer in circumstances where any actual or potential conflict of interest impedes or is likely to impede its ability to provide competent advice to the new applicant or listed issuer in a professional and impartial manner: 1. A sponsor may not be the legal adviser or be involved in accounting matters (although, subject to certain conditions, it may act as a co-sponsor).	• Sponsor's are required to provide a declaration of independence to the UKLA at the commencement of any significant transaction. In reviewing that declaration the following would give rise to concerns on a sponsor's independence: 1. Another company in the sponsor's group is interested in 3% or more of the share, debt or loan capital of an issuer or any other company in an issuer's group.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
4. A sponsor is controlled by or under the same control as the new applicant; 5. Material part (15%) of the proceeds raised from an IPO is applied to settle debts due to the sponsor's group; 6. A significant portion of the applicant's operation is funded by the banking facilities provided by the sponsor group; and		2. A sponsor shall not be prohibited from acting for an issuer on account of any lending, in the ordinary course of business, by the sponsor. 3. The sponsor may own securities in the issuer. (As an internal guideline, the maximum limit is 5%).	2. Business relationships with an issuer that could give the sponsor or another company in the sponsor's group a material interest in the success of a transaction. 3. Financial interests in an issuer including fee arrangements, loans to the issuer and security over the assets of the issuer by the sponsor or another company in the sponsor's group that could give the

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
7. A director or employee of the sponsor or their associates has an interest in or business relationship with the applicant. 8. Acting as auditor or reporting accountant.			sponsor or another company in the sponsor's group a material interest in the success of a transaction. 4. A sponsor employee has an interest in a class of share, debt or loan capital of an issuer.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
Duties and responsibilities			
• Further detailed codification of the duties and responsibilities of sponsors and IFAs to be provided. A Code of Conduct for Sponsors and Independent Financial Adivsers will be incorporated into the rules.	• A sponsor has a particular role to satisfy itself, on all available information, that the issuer is suitable to be listed and it must also satisfy itself that its directors appreciate the nature of their responsibilities and can be expected to honor their obligations under the Listing Rules and Listing Agreement.	• A sponsor must be closely involved in the preparation of the listing document and must ensure that it has been verified to a standard that enables the sponsor to submit to the Exchange the declarations, which confirm, inter alia, that it has satisfied itself, to the best of its knowledge and belief and having made due and careful enquiries, that: (i) the new applicant is suitable for listing on GEM; (ii) the directors appreciate the nature of their responsibilities and can	• The general obligations which are similar to our GEM Listing Rules are subject to the exercise of due care and skill. In respect of certain specified declarations the test is supplemented by an obligation of having made due and careful enquiry of the issuer and its advisers. • There are no criteria for the due diligence that a sponsor is expected to undertake.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
	• Under the Model Code for Sponsors, a sponsor should be closely involved in the preparation of a listing document and ensure that all material statements therein have been verified and that it complies with the Main Board Listing Rules and all relevant legislation.	be expected to honor their obligations under the GEM Listing Rules; (iii) the information contained in the listing document is accurate and complete in all material respects and not misleading; and (iv) there are no other matters the omission of which would make any statement in the document misleading.	• The specific declarations relate to: directors' understanding of their obligations; the adequacy of financial reporting procedures; the sufficiency of working capital; profit forecasts; the proper extraction of financial information from the underlying records and in some circumstances the adequacy of non-financial reporting procedures (typically technology start ups).

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
	• No current requirements under the Main Board Listing Rules.	• Where a listed issuer issues a listing document (prospectus, rights issue or open offer document, or notifiable transaction document) within the sponsorship period, the above applies to the sponsor.	• No current requirements.
	• No current obligations in the Main Board Listing Rules or Model Code regarding IFA due diligence.	• No current obligations in the GEM Listing Rules regarding IFA due diligence.	• No current requirements.
• Sponsors and lead underwriters (where the latter are different from the former) should certify the extent of their due diligence in establishing that any listing document requiring registration contains full and accurate disclosure.	• Sponsors are not required to sign the prospectus. However, under statute, they would bear both civil and criminal liability as persons who "authorized the issue of the prospectus" for views they expressed as experts.	• Sponsors are not required to sign the prospectus. However, under statute, they would bear both civil and criminal liability as persons who "authorized the issue of the prospectus" for views they expressed as experts.	• Sponsors are not required to sign the prospectus nor under the UK Listing Rules to take any overall responsibility for the listing document except under common law and statute if they are regarded as promoters.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
			• To assist the UKLA in discharging its document and listing approval function sponsors provide a confirmation, on which the UKLA places reliance, in respect of the issuer's compliance with the UK Listing Rules including those relating to the completeness and accuracy of the listing document. • Under statute they take responsibility for those parts of the prospectus in which they provide expert opinions. The same approach applies to accountants, appraisers and other experts, where relevant.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• A firm from the sponsor list to provide on going advice in a defined period immediately after listing.	• Sponsors are required to act as the continuing sponsor of H-Share applicants after their listing for a period of one year. • For other Main Board applicants, it is recommended that they retain the services of its sponsors for at least one year following listing.	• Sponsors are required to act as the continuing sponsor of a GEM applicant after its listing covering at least the remainder of the financial year during which the listing occurs and the 2 financial years thereafter.	• No mandatory continuing sponsorship requirement. • Sponsors are required to be appointed in respect of any significant transaction and may be required in the event of a breach of the rules. • UK Listing Authority recommends that issuers consult advisers to ensure that they meet their obligations. A sponsor firm is subject to the Listing Rule obligations of due care and skill in these circumstances.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
• Sponsors must have the right to resign (e.g. if there is dispute over its fees), in which case the issuer is required to appoint a new sponsor within 3 months. The sponsor is required to report to the Exchange the reasons for its resignation. An IFA must also have the right to resign if it is not able to discharge its role and responsibilities (e.g. due to the company not cooperating or providing enough information). Similarly, the IFA is required to report to the Exchange the reasons for its resignation.	• The H-Share issuer should not terminate the role of continuing sponsor until the issuer has appointed a replacement acceptable to the Exchange. Both the H-Share issuer and the continuing sponsor should immediately notify the Exchange the reasons why the appointment was terminated.	• During the sponsorship period, a sponsor may only terminate its role in exceptional circumstances, where it is no longer able satisfactorily to perform the role, and only after first notifying the Exchange of the intended termination and the reasons therefor. The issuer is required to appoint a replacement within 3 months.	• No current requirements. • When a sponsor resigns there is no obligation to make a statement to the UKLA of the circumstances. This is only required in circumstances of dismissal.

Brief description of our recommendation	Existing Main Board Rules	Existing GEM Rules	UK Requirement
Sanctions			
• Sanctioning of sponsors, IFAs and individuals with a range of sanctions similar to that in Chapter 2A of the Main Board Listing Rules and Chapter 3 of the GEM Listing Rules.	• In theory the Exchange may take disciplinary proceedings against a sponsor or a financial adviser for breaches of the Main Board Listing Rules, but not if the sponsor fails to ensure compliance by the issuer. As the Main Board Listing Rules generally do not impose direct obligations on sponsors no disciplinary action has been taken against sponsors.	• Where the Exchange determines that a sponsor or a financial adviser has breached or failed to discharge any of its responsibilities or obligations under the GEM Listing Rules, it may take disciplinary proceedings against the party concerned.	• Where the UK Listing Authority determines that a sponsor or a financial adviser has breached or failed to discharge any of its responsibilities or obligations under the UK Listing Rules, it may take disciplinary proceedings against the party concerned. • The only sanction available to UKLA is a public censure. It has no fining power in respect of sponsors.

The United States

The role of sponsor, as it exists in the United Kingdom and Hong Kong system, does not exist in the United States system. The Securities and Exchange Commission ("SEC") does not seek directly to regulate the conduct of firms lead managing IPOs – the bulk of US regulation of intermediaries is aimed at those who deal in securities. In primary market matters, the SEC relies largely on the requirement, established by the Securities Act of 1933 and subsequent interpretations, that all material facts must be disclosed in any prospectus. Lead underwriters take formal legal responsibility for the accuracy and completeness of statements made by issuers they are advising. Adequate due diligence is the only effective defence in the event of civil action by aggrieved shareholders or the SEC. Since the fear of punitive damages is a very real one in the United States, this system has generally been sufficient to maintain high standards of due diligence. The SEC (which has no powers of criminal prosecution) can, in addition to filing normal civil suit, take "administrative action", which involves bringing a case to a specialist judge, called an Administrative Law Judge.

The SEC reviews all IPO documentation filed with them and selectively reviews subsequent filings. It frequently asks for further disclosure or clarification, especially if the transaction breaks new ground, or the issuer is from outside the United States. The SEC does not approve or disapprove prospectuses. However, generally, before an issuer can publicly offer securities in the United States the offer and sale of securities must be registered. Securities will be considered registered when the SEC "declares effective" a registration statement incorporating the prospectus.

Australia

Australian law and practice in relation to applications for listing and IPOs emphasize disclosure over suitability for listing. The Australian Stock Exchange is responsible for listing of issuers. The criteria for suitability of listing is based on a set of quantitative rather than qualitative requirements, although the Exchange has powers to determine qualitative suitability. These powers are never used apparently because of the inherent subjectivity and the consequent exposure to legal action from unsuccessful applicants. The prospectus disclosure requirements are contained in the Corporations Act 2001 and involve civil liability in the event the contents are false or misleading. Prospectuses are not pre-vetted. The Australian Securities and Investments Commission ("ASIC") selectively post-vets prospectuses and in the event it reaches the view that the contents of the prospectus are false or misleading, it may issue an interim or final stop order preventing the issuer from accepting offers to subscribe to

the securities. ASIC may also require a supplementary prospectus to clarify matters reported in the original prospectus or emerging as a result of enquiries by ASIC or the Australian Stock Exchange. The Australian Stock Exchange may also require "pre-quotation disclosure" of circumstances which have occurred since the Prospectus was issued or matters reported in the prospectuses which the Exchange believe need clarification or amplification.

The role of sponsor does not exist in Australia. Nor are lead underwriters required to sign the prospectus. Intermediaries who deal in securities or who provide financial product advice (which include statements intended to influence persons in relation to investment decisions) require an ASIC licence. This includes not only promoters and underwriters but may also reporting accountants and other professionals who express opinions which are included in disclosure documents and which may be relied on by investors. ASIC may bring disciplinary action to suspend or revoke a licence for breaches of the Corporations Act 2001 or for not performing duties efficiently, honestly and fairly.

Experts must give their consent before a statement or opinion expressed by them can be included in the prospectus. Any intermediary or professional who participates in the preparation of a prospectus or whose opinion is included in the prospectus may be liable for misstatements subject to a due diligence defence. While Australian investors have not traditionally been as active as US investors in bringing class actions in relation to the contents of disclosure documents, in recent years such actions have been brought against companies, their directors and their advisers including corporate finance advisers, accountants and lawyers (either directly or after being joined by the company and its directors), e.g. GIO shareholders in relation to the Part B Statement issued in response to the AMP takeover offer.

Canada

In 1999 the Toronto Stock Exchange (TSX) became Canada's sole senior equity exchange and the Canadian Venture Exchange (CDNX), created through a merger of the Vancouver and Alberta (and later Winnipeg) exchanges, took over sole responsibility for junior equity. In May 2001, the TSX acquired the CDNX, thus bringing all of Canada's equity trading under one organization. The regulation of the Canadian securities industry is carried out by the provinces and territories, with each of them having their own securities regulator. The 13 provincial and territorial regulators collaborate through the Canadian Securities Administrators.

Under the rules of the TSX, sponsorship is required in regard to every application for a new listing, and every application by a Tier 2 issuer to conduct a Change of Business. Sponsorship may also be required by the TSX in regard to other significant transactions by issuers where it is considered necessary or advisable by the TSX. A sponsor must be a Member of the TSX and meet standards of business that are substantially the same as those proposed by the Exchange (including employing at least one senior corporate finance officer who is licensed and has at least five continuous years of relevant experience with an underwriter and employing one industry expert in respect of each area of business undertaken). In making a determination as to whether an issuer meets the TSX's listing requirements and is suitable for listing on the TSX, the TSX states that it relies heavily upon the fact that a sponsor has agreed to sponsor the issuer and has agreed to prepare and submit a Sponsor Report to the TSX. The TSX expects that the sponsor will conduct a duly diligent review ("Due Diligence"), appropriate to the circumstances, in connection with the sponsorship of an applicant issuer and that such Due Diligence will be substantially similar to that which would be conducted by an underwriter in connection with the underwriting of a public offering. The TSX requires the sponsor to file a "Sponsor Report" in connection with every listing by a new applicant and certain subsequent transactions. The Sponsor Report must clearly document the Due Diligence performed by the sponsor in respect of the issuer and each of its directors, senior managers and principal shareholders. The TSX's Sponsorship Policy Statements clearly state the minimum Review Procedures which must be performed prior to execution of a Sponsor Report.

The Securities Act in Ontario (which is substantially replicated in the other provinces) imposes civil liability for misstatements and material omissions in prospectuses on the directors and the underwriters. As in the USA, there is a "reasonable inquiry" defence for underwriters. At the end of 2002, the province of Ontario decided to create a new statutory civil remedy for investors. The proposed new civil remedy regime will provide investors in the secondary market with a limited right of action to seek compensation for damages resulting from a misrepresentation in public disclosure or a failure to make disclosure of a material change in continuous disclosures.

ANNEX 2

The Stock Exchange of Hong Kong Limited

PROPOSED CODE OF CONDUCT FOR SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

A. INTRODUCTION

1. The Code forms part of the Listing Rules and a breach of the requirements of the Code constitutes a breach of the Listing Rules and is subject to the sanctions contained in Main Board Listing Rule 2A.09 and GEM Listing Rules 3.10, 6.67 and 6.68. Pursuant to the Corporate Finance Adviser Code of Conduct issued by the SFC, a registered person engaging in corporate finance advisory work is required to observe the requirements of the Listing Rules, which includes observing the requirements of this Code. The SFC's Code states that any breach of this Code will prima facie cast doubts on the fitness and properness of that person with respect to their registration under the SFO.

2. The requirements in section B of this Code only apply to sponsor firms and IFA firms. A reference to a "sponsor" in Section B of this Code only is a reference to a sponsor firm including a sponsor firm acting as an IFA and an IFA firm. Eligible supervisors and directors of sponsor firms or IFA firms are required to use their best endeavours to ensure that sponsor firms or IFA firms comply with the requirements in Section B of this Code.

3. The requirements in Section C of this Code apply to sponsor firms, IFA firms and their eligible supervisors. A reference to a "sponsor" in Section C of this Code is a reference to a sponsor firm, including a sponsor firm acting as an IFA and an IFA firm or an eligible supervisor of a sponsor firm or an IFA firm.

4. The requirements in Section D of this Code apply to sponsor firms, IFA firms, eligible supervisors and other directors and staff of sponsor firms or IFA firms who do sponsor work or IFA work. A reference to a "sponsor" in Section D

of this Code is a reference to a sponsor firm, including a sponsor firm acting as an IFA and an IFA firm, an eligible supervisor or other directors and staff of sponsor firms or IFA firm who do sponsor work or IFA work.

5. A failure by a sponsor firm, IFA firm, eligible supervisor or director or staff member to a sponsor firm or IFA firm to meet the requirements of the Code applicable to them may result in disciplinary proceedings and the imposition of sanctions.

6. Terms used in this Code which are defined or interpreted in the Listing Rules shall have the same meaning as in the Listing Rules. A reference to a controlling shareholder is a reference to a person who has an interest in or is able to exercise voting rights in respect of, 30 percent or more of the issued share capital or is able to influence or control the appointment of two or more directors.

B. REQUIREMENTS APPLICABLE TO SPONSOR FIRMS

7. A sponsor firm must:

   (a) maintain effective supervisory, monitoring and reporting controls;

   (b) maintain an effective compliance function independent of other business functions, reporting directly to the board of directors, and with the necessary technical competence, resources and experience;

   (c) ensure that it has adequate competence, professional expertise and, human and technical resources for the proper performance of its duties and responsibilities; and

   (d) maintain proper books and records, retain records in respect of each corporate finance transaction for a period of 7 years after the transaction closes, and be able to provide a proper trail of work, including but not limited to documents recording communications between the sponsor and the issuer and the Exchange, documents evidencing the due diligence investigations conducted in relation to each transaction and supporting documentation and documents and records evidenced the manner in which the sponsor has addressed inquiries from the Exchange, upon request by the Exchange.

8. The sponsor must sign the listing application and lodge it, together with all supporting documentation, with the Exchange in accordance with Chapters 9 and 20 of the Main Board Listing Rules and Chapter 12 of the GEM Listing Rules.

9. The sponsor can only terminate its role as sponsor in exceptional circumstances where it is no longer able satisfactorily to perform that role and only after first notifying the Exchange of such proposed terminations and the reasons therefor.

10. If the issuer terminates the sponsor role, the terminated sponsor must immediately notify the Exchange of such termination stating the reasons why it believes such appointment was terminated. The newly appointed sponsor must immediately notify the Exchange of its appointment.

C. REQUIREMENTS APPLICABLE TO SPONSOR FIRMS AND ELIGIBLE SUPERVISORS

General

11. A sponsor must be closely involved in, and take overall responsibility for, the preparation of listing documents and any other documents (including all public announcements) required by the Listing Rules during the sponsorship period, and must ensure that the documents are in compliance with the Listing Rules and all relevant legislation.

12. A sponsor must:

    (a) take all reasonable steps to avoid situations that are likely to involve a conflict of interest; and

    (b) withdraw from, or decline to accept, a mandate where a material conflict of interest arises which would impede or is likely to impede their ability to provide competent advice to an applicant or issuer in a professional and impartial manner; or their ability to perform their obligations under this Code or the Listing Rules, including in circumstances in which it considers an applicant is not suitable for listing or an issuer has committed a material breach of the Listing Rules.

13. The sponsor must deal with all matters raised by the Exchange arising in connection with the listing application or in any circumstances in which the sponsor acts in that capacity, in connection with the issuer's continuing obligations.

14. The sponsor must accompany the applicant or issuer at any meetings with the Exchange which the applicant or issuer is asked to attend, unless the Exchange requires otherwise.

IPO Sponsorship

15. A sponsor must certify that:

    (a) they have read the answers which each director, or proposed director, of the issuer is required to provide in response to the question in Part 1 of the relevant forms of Declaration and Undertaking with regard to Directors set out in Appendix 5 of the Main Board Listing Rules and Appendix 6 of the GEM Listing Rules; and

    (b) as at the date of certification they are not aware of any information that would lead a reasonable person to inquire further concerning the truthfulness, completeness or accuracy of any of the answers given.

    The certification shall be in the form provided in Part 3 of such form as set out in Appendix 5 of the Main Board Listing Rules and Appendix 6 of the GEM Listing Rules.

Due Diligence

16. The Exchange expects that the sponsor will conduct a duly diligent review ("Due Diligence"), appropriate to the circumstances, in connection with the sponsorship of a new applicant. This section of the Code sets forth the minimum review procedures ("Review Procedures") required to be conducted in connection with the preparation of a listing document by a new applicant.

17. In making a determination as to whether a new applicant meets the requirements of the Listing Rules and is suitable for listing on the Exchange, the Exchange relies heavily upon the fact that an acceptable sponsor has agreed to sponsor the applicant and on the Due Diligence performed by that sponsor.

18. For the purpose of interpretation of the Due Diligence requirements of this Code, any part of a listing document purporting to be made on the authority of an expert or purporting to be a copy of or an extract from a report, opinion or statement of an expert, shall be called the "expert sections". Other parts of the listing document are the "non-expert sections".

19. The Due Diligence obligations of sponsors set out in paragraphs 21-25 below are expressed as general principles. However, this Code is not in any way intended to set forth a standard of appropriate Due Diligence. This Code only prescribes the minimum Review Procedures to be conducted in connection with the preparation of a listing document. The sponsor must exercise its own judgement in the relevant context and circumstances as to what investigations or steps are necessary to satisfy the general obligations. In each paragraph sponsors are provided with a non-exhaustive set of minimum Review Procedures as guidance. However, sponsors should not expect that doing no more than completing those minimum Review Procedures will satisfy the general obligation. The scope and extent of appropriate Due Diligence by a sponsor may be different from or may be considerably more extensive than the Review Procedures described below. Sponsors will need to demonstrate that they have turned their minds to the question of what additional investigations or procedures are necessary and the question of the intensity and thoroughness with which they need to investigate any particular aspect of the Due Diligence. In relation to the latter question, for example, the sponsor in conducting "reasonable investigations" cannot simply accept at face value documents produced and statements made by the management of the applicant or issuer. In the event that a sponsor when conducting "reasonable investigations" in compliance with this Code, identifies or should reasonably have identified a problem, the sponsor must conduct more detailed, extensive and intrusive investigations in respect of the problem subject matter.

20. A sponsor must conduct reasonable investigations to satisfy themselves that the new applicant will meet the applicable distribution requirements, with the required minimum number of public shareholders required by the relevant Listing Rules. The sponsor must satisfy themselves that the free public float at the time of the issuer's admission is genuine, represents bona fide shareholders independent of controlling shareholders and complies with the requirements of the Listing Rules. The scope of reasonable investigations should include but not be limited to checking the credentials of the

underwriters, sub-underwriters and any placement agents. In making such determination, the sponsor may not simply rely on assurances given by the directors of the issuer and must make arrangements to ensure that all of the public shareholders are genuinely unconnected to, and not financially supported by, any connected person.

21. A sponsor must conduct reasonable investigations to satisfy themselves that the new applicant is suitable for listing and that the new applicant and its directors appreciate the nature of their responsibilities and obligations under the Listing Rules and the Listing Agreement (for Main Board issuers only) and can be expected to honour those responsibilities and obligations (refer to Main Board Listing Rule 3.04 and GEM Listing Rule 6.47). The latter requirement continues to operate after the applicant becomes an issuer whenever the sponsor advises the applicant in relation to compliance with the Listing Rules or the Listing Agreement. The scope of the reasonable investigations should include but not be limited to:

    (a) the new issuer's compliance with the applicable minimum listing requirements of the Exchange;

    (b) the experience, qualifications, competence and integrity of the issuer's directors to manage the issuer's business and ensure compliance with the Listing Rules and the Listing Agreement;

    (c) the extent of initial and continuing training each director has received and will receive about the nature and significance of the responsibilities and obligations they will be accepting as directors of a listed issuer; and

    (d) the effectiveness of the internal control procedures and accounting and management information systems to ensure directors are made aware of all information relevant to compliance with the Listing Rules and the Listing Agreement.

Management, directors and controlling shareholders

22. In respect of the existing and any proposed directors and senior management, the sponsor must conduct a review of their general business acumen, their experience in the type of business carried on by the new applicant, their securities and industry related experience and responsible business conduct and practices. Reasonable investigations should include but not be limited to:

    (a) performing checks to ensure that the sponsor is not aware of any information that would lead a reasonable person to question the truth, accuracy or completeness of any of the answers given in each directors' undertaking;

    (b) confirmation of educational and professional qualifications;

    (c) inquiries with regulatory bodies, data base searches (e.g. LexisNexis) and reference checking;

    (d) searches for civil actions and judgements;

    (e) reviewing the financial and regulatory track record of other listed companies of which the issuer's directors have been directors by reference to annual reports, company disclosures, media articles and information about those companies on the web-site of the relevant exchange;

    (f) confirmation of the amount of time to be devoted to the business of the issuer and an assessment of whether each of the directors is committing sufficient time to properly manage the business and corporate affairs of the listed issuer;

    (g) a review of their past conduct for purposes of assessing their general experience; and

    (h) the sponsor being reasonably satisfied, based on the sponsor's assessment of the past conduct and experience of the directors and senior management, that:

(i) such persons can reasonably be expected to prepare and publish all information required by applicable securities laws and the Listing Rules, including without limitation the SFO, in a timely and responsible manner; and

(j) such persons appreciate the nature of their responsibilities as directors or officers of an issuer listed on the Exchange.

23. The Sponsor must undertake a review of the past conduct of controlling shareholders for the purpose of determining whether they have demonstrated a history of regulatory and legal compliance and integrity. This should include but not be limited to:

(a) inquiries with regulatory bodies which have jurisdiction over other companies with which the controlling shareholder has been associated or securities or other regulated business activities in which the controlling shareholder has been engaged; and

(b) searches, including appropriate data base searches such as LexisNexis searches, and searches for civil and criminal actions and judgements, in relation to the controlling shareholder and companies or businesses with which he or she has been associated, in so far as is practicable.

Business of the issuer

24. A sponsor must conduct reasonable investigations to satisfy themselves that non-expert sections contained in the listing document are true and do not omit a material fact. The extent of reasonable investigations in relation to listing documents should be greater than for other disclosure documents. The scope of reasonable investigations should include but not be limited to:

(a) assessing management's goals and expenditure controls to determine whether it is reasonable to assume that management will use the proceeds of the issue and any working capital as publicly disclosed;

(b) review the material financial statements of the issuer over the past 3 years to assess the integrity of financial information. Such review would include interviewing the issuer's accounting staff and internal and external auditors and obtaining comfort from the issuer's external auditor or reporting accountants based on agreed upon procedures, where relevant;

(c) review, assess or interview the issuer's major suppliers and customers;

(d) assessing the issuer's business plan and forecasts including an assessment of the reasonableness of the budgets and projections and whether the projections and assumptions are consistent with the issuer's past performance having regard to historical sales and revenue and investment returns, payment terms with suppliers, costs of financing, long-term liabilities and working capital requirements. This would include extensively interviewing the issuer's senior management and third party customers, suppliers, creditors and bankers;

(e) a physical inspection of material assets, whether owned or leased, including property, plant, equipment and inventory used, or to be used, in connection with the issuer's stated business objectives;

(f) if applicable, an analysis of the issuer's production methods;

(g) if applicable, an analysis of the issuer's actual or proposed marketing plan, including distribution channels, pricing policies, after sales service, maintenance and warranties;

(h) reviewing all the business aspects of all material contracts of the issuer;

(i) reviewing all material legal proceedings, and proceedings known to be contemplated, involving the issuer;

(j) an analysis of the business aspects of any legislation or publicly available proposed legislation, that in the sponsor's judgement may materially affect the issuer's operations;

(k) an analysis of the business aspects of any economic or political conditions that, in the sponsor's judgement, may materially affect the issuer's operations;

(l) investigations of the industry and target markets in which the issuer's business will principally operate or its management anticipates that it will principally operate, including geographical area, competition within that segment (including existing and potential principal competitors and their relative size and aggregate market share) and market segment;

(m) if appropriate, investigation and confirmation of the existence of any proprietary interests, intellectual property rights and licensing arrangements material to the issuer's business;

(n) investigation of the technical feasibility of any new product or technology developed, under development or proposed to be developed pursuant to the issuer's business plan; and

(o) investigation of the stage of the applicant's development and the commercial viability of its product or technology, including an assessment of obsolescence, market controls or regulation and seasonal variation.

25. A sponsor must take all reasonable steps to satisfy themselves that there are not reasonable grounds to believe that the expert sections contained in the new applicant's listing application and listing document are not true or omit a material fact. Such reasonable steps should include but not be limited to:

(a) investigating the background and expertise of the relevant expert or professional;

(b) agree the scope of work;

(c) in relation to any expert or professional opinion, assessing the reasonableness of the assumptions used and any qualifications made and the consequences of such assumptions and qualifications for the extent to which investors could rely on such opinion;

(d) reviewing the expert sections in the context of all the other information in the sponsor's possession as a consequence of its reasonable investigations and general knowledge of the applicant and its industry and market. In the event that the sponsor discovers any material

discrepancy or inconsistency, it would be unreasonable for the sponsor not to conduct further inquiries. Such further inquiries should include but not be limited to reviewing the relevant source material and interviewing the expert or professional and senior management of the applicant; and

(e) confirming that the expert or professional does not have a relationship with the issuer that may lead a reasonable person to conclude that the expert's or professional's independence or objectivity could be compromised. The sponsor must confirm that the expert or professional does not have any direct, indirect or contingent interest in any of the securities or assets of the issuer, its connected persons, or any associate or affiliated company of the issuer.

26. If requested by the Exchange, the sponsor must produce a detailed written report for the Exchange that:

(a) confirms that the Review Procedures have been conducted or, to the extent permitted, identify any Review Procedures not conducted and the reasons such Review Procedures were not conducted;

(b) identify the significant Review Procedures conducted;

(c) identify any information which the sponsor is or has become aware of in the course of conducting its Review Procedures or its Due Diligence which may reasonably be expected to be of significance to the Exchange in determining the suitability of the listing of the issuer; and

(d) confirm that the sponsor has favourably concluded upon the suitability for listing of the issuer.

Ongoing sponsorship

27. A sponsor must certify that:

    (a) they have read the answers which each proposed new director of the issuer is required to provide in response to the question in Part 1 of the relevant forms of Declaration and Undertaking with regard to Directors set out in Appendix 5 to the Main Board Listing Rules and Appendix 6 of the GEM Listing Rules; and

    (b) as at the date of certification they are not aware of any information that would lead a reasonable person to inquire further concerning the truthfulness, completeness or accuracy of any of the answers given.

    The certification shall be in the form provided in Part 3 of such form as set out in Appendix 5 of the Main Board Listing Rules and Appendix 6 of the GEM Listing Rules.

28. If an issuer seeks a waiver from the Exchange in relation to material ongoing connected party transactions, the sponsor must conduct reasonable investigations to satisfy themselves that such transactions are conducted at arm's length and on normal commercial terms.

29. A sponsor, when acting in that capacity for a listed issuer, must conduct reasonable investigations to satisfy themselves that non-expert sections contained in any disclosure document (including public announcements) required by the Listing Rules are true and do not omit a material fact. The extent of reasonable investigations in relation to listing documents should be greater than for other disclosure documents.

IFA work

30. A sponsor or financial adviser when retained as an IFA in relation to a connected transaction that require any shareholders to abstain from voting or a transaction or arrangement that require controlling shareholders to abstain from voting must take all reasonable steps to satisfy themselves that the terms of the subject transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole, and that there are no reasonable grounds to believe that any information, expert advice or opinion relied on in relation to the transaction or arrangement are not true or omit a material fact. Such reasonable steps should include but not be limited to:

    (a) obtaining all information and documents of the issuer relevant to an assessment of the fairness and reasonableness of the terms of the transaction. For example, if the transaction involves the purchase or sale of products or services, obtain information and documents showing the prices at which the issuer buys and sells such products and services to third parties;

    (b) thoroughly researching the relevant market and economic conditions and trends relevant to the pricing of the transaction;

    (c) reviewing the reasonableness of any assumptions or projections relevant to the transactions;

    (d) in relation to any third party expert providing an opinion or valuation relevant to the transactions:

        (i) investigating the background, expertise and independence of the third party expert;

        (ii) assessing the appropriateness of the scope of work; and

        (iii) reviewing the reasonableness of any assumptions, projections or qualifications in the expert's report and the extent to which the consequences of such for the transaction are fully articulated in the report; and

(e) reviewing and assessing the alternative offers and the reason given by the management (if any) for rejecting these offers and ensuring that adequate and balanced disclosure of this information and analysis is provided in the IFA's report.

D. REQUIREMENTS APPLICABLE TO SPONSOR FIRMS, ELIGIBLE SUPERVISORS, AND DIRECTORS AND STAFF OF SPONSOR FIRMS

31. A sponsor must be honest, of good repute and character, and should maintain a high standard of integrity and fair dealing. A sponsor must respond truthfully and fully to any requests by the Exchange for information or documents.

32. When advising an applicant or issuer, a sponsor has a responsibility to ensure that the issuer or applicant is properly guided and advised and must discharge that responsibility with due care and skill.

E. REQUIREMENTS APPLICABLE TO IFAS

33. In order for a sponsor to act as an IFA under the Listing Rules, the sponsor firm must be completely independent of the relevant listed issuer, in accordance with the following test:

    (a) the sponsor firm and all of its eligible supervisors must not have any other business relationships with, or financial interests in, the issuer or any of its connected persons; and

    (b) the sponsor firm and all of its eligible supervisors must not have acted as a corporate finance adviser or other financial adviser to the issuer or its connected persons in the two years prior to such appointment.

ANNEX 3

SUMMARY OF QUESTIONS

ACCEPTABLE SPONSOR FIRMS

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

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

Q.1 Do you agree with our proposal?

☐ *Yes*

☐ *No*

Please state reason(s) for your view

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ACCEPTABLE IFA FIRMS

(Paragraphs 52 to 53 of Part B of the Consultation Paper)

We propose that only firms on the list of acceptable sponsors or acceptable IFAs be eligible to act IFAs to issuers in relation to a connected party transaction. We propose that a process similar to that for admitting firms to the list of acceptable sponsors be adopted for IFA firms.

Q.2 Do you agree with our proposal?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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ACCEPTABLE INDIVIDUALS

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

We propose that only individuals who:

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

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

(c) are not on the list of unacceptable individuals

may do sponsor work or IFA work.

Q.3 Do you agree with our proposal?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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CRITERIA FOR INCLUSION ON THE LIST OF SPONSORS AND IFAs

Competence and experience of the sponsor and IFA firms
(Paragraphs 60 to 66, 73 and 79 of Part B of the Consultation Paper)

We propose that the focus of our requirements will be on the experience of the individual member of staff, rather than the sponsor firm or IFA firm and that sponsor firms have at least four eligible supervisors and IFA firms have at least two eligible supervisors.

Q.4 Do you agree with our proposal?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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

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

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

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

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

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

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

Q.5 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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

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

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

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

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

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

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

Q.6 Do you agree with our proposal?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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Minimum Capital Requirement of Sponsor Firms
(Paragraphs 82 to 85 of Part B of the Consultation Paper)

We propose that sponsor firms are required to meet and maintain a minimum capital requirement of "total paid-up share capital and/or non-distributable reserves of not less than HK$10 million represented by unencumbered assets and a net tangible asset value after minority interests of not less than HK$10 million". Should the sponsor firm be unable to meet the capital requirement, we propose to accept as an alternative an unconditional and irrevocable guarantee from a company within the sponsor group or an authorized institution of not less than HK$10 million.

We do not propose that IFA firms should be subject to a similar requirement.

Q.7 (a) Do you agree with our proposal for sponsor firms?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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Undertakings to the Exchange
(Paragraphs 95 to 97 of Part B of the Consultation Paper)

We propose that each of the sponsors and IFAs seeking to be admitted to the list of Sponsors or list of IFAs be required to declare that the contents of its application to be admitted to the list is true and does not omit any material fact. We also propose that each of the sponsors and IFAs seeking to be admitted to the list must sign an undertaking to the Exchange to comply with the relevant Listing Rules applicable to sponsors or IFAs, including the proposed Code of Conduct for Sponsors and Independent Financial Advisers; and to assist the Exchange with investigations, including by producing documents and answering questions fully and truthfully. Furthermore, we propose that eligible supervisors be required to provide the Exchange with a written undertaking in similar terms to that provided by sponsors firms and IFA firms. This will include an obligation to comply with the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. The proposed Code of Conduct for Sponsors and Independent Financial Advisers includes an obligation that the eligible supervisors and directors of sponsor firms and IFA firms use their best endeavours to ensure the sponsor firm or IFA firm complies with its obligations under the Listing Rules and the proposed Code of Conduct for Sponsors and Independent Financial Advisers. A breach of the undertaking will be deemed to be a breach of the Listing Rules and will be subject to disciplinary action.

Q.8 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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APPOINTMENT

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

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

After the new applicant is listed, we propose that:

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

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

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

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

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

Q.9 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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INDEPENDENCE

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

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

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

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

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

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

Q.10 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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RESPONSIBILITIES

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

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

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

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

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

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

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

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

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

Q.11 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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CODE OF CONDUCT FOR SPONSORS AND INDEPENDENT FINANCIAL ADVISERS

(Annex 2)

At Annex 2 we set out the proposed Code of Conduct for Sponsors and Independent Financial Advisers.

Q.12 Do you agree with the approach adopted in the proposed Code of Conduct for Sponsors and Independent Financial Advisers?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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

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

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

Q.13 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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IFA Due Diligence Declaration
(Paragraph 147 of Part B of the Consultation Paper)

We propose that IFAs are required to take all reasonable steps to satisfy themselves that the terms and conditions of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole, and that there are no grounds to believe that any information, expert advice or opinion relied on in relation to the transaction or arrangement are not true or omit a material fact. IFAs should include in their reports a signed declaration setting out the due diligence they have performed in order to reach a conclusion that the terms of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole.

Q.14 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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REPORTING OBLIGATIONS AND MONITORING

(Paragraphs 166 to 170 of Part B of the Consultation Paper)

We propose to replace the requirement for an annual review with a certification process and a targeted programme of monitoring.

We propose to require sponsor firms and IFA firms and their eligible supervisors to submit annual confirmations that they remain eligible to act in such capacity. In addition, they are required to report to the Exchange as soon as they became aware if they no longer satisfy the eligibility criteria set out in the Listing Rules or any information provided by them in connection with their application or continued inclusion on the list of Sponsors or the list of IFAs has changed. The Exchange may also conduct a specific review in relation to the continued inclusion of the sponsor firm or IFA firm (or any of it's employees) if it becomes aware or has reason to believe that the suitability of the firm/individual may be in question.

The monitoring tools we propose to use will vary according to circumstances and may include one or more of the following:

- Complaints;
- Desk based reviews of transactions;
- Reviews of referrals;
- Liaison with other agencies, professional or regulatory bodies;
- Meetings with management and other representatives from a sponsor firm or IFA firm;
- On-site visits after prior notification;
- Reviews of notifications and confirmations from sponsors or IFAs; and
- Reviews of past services provided, and documentation produced, pursuant to the Listing Rules by a sponsor or an IFA.

Q.15 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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COMPLIANCE AND SANCTIONS

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

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

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

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

Q.16 Do you agree with our proposals?

☐ *Yes*

☐ *No*

Please state reason(s) for your view.

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ABILITY OF EXISTING GEM AND MAIN BOARD SPONSORS AND IFAS TO MEET ELIGIBILITY CRITERIA FOR ACCEPTABLE LISTS

(Paragraphs 186 to 189 of Part B of the Consultation Paper)

For those respondents to this Consultation Paper who are currently on the list of GEM Sponsors or who currently perform or who have in the past 2 years performed work as Sponsor to Main Board applicants for listing or have in the past 2 years acted as an IFA, we would appreciate your response to the following questions:

Q.17 Would you meet the proposed eligibility requirements for sponsor firms or IFA firms (whichever is applicable), including the requirement that sponsor firms have four eligible supervisors and HK$10 million capital or that IFAs have two eligible supervisors if those requirements:

(a) *were in effect today?*

☐ *Yes*

☐ *No*

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

☐ *Yes*

☐ *No*

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

☐ *Yes*

☐ *No*

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

☐ *Yes*

☐ *No*

Q.18 If your answer to any of questions 17 (a)-(d) was negative, please state which criteria would cause your firm not to meet the requirements and comment on whether the proposed transitional arrangements would give you a sufficient opportunity to meet all the requirements? Would this change if the second transition period (in which existing GEM sponsors would only be required to have 3 eligible supervisors to be on the list of acceptable sponsors) was 2 years instead of 1 year? Do you have any other suggestions or comments on how to address the issues arising out of the impact analysis at paragraphs 186 to 188 of Part B of this Consultation Paper?

ANNEX 4

HKEx STATEMENTS OF POLICY ON PERSONAL DATA

PERSONAL INFORMATION COLLECTION STATEMENT

This Personal Information Collection Statement ("PICS") is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which the Personal Data of respondents will be used after collection, what these respondents are agreeing to in respect of The Hong Kong Exchanges & Clearing Limited's ("HKEx") use of their Personal Data and their rights under the Personal Data (Privacy) Ordinance.

Purpose of Collection

HKEx may use the Personal Data of respondents collected by HKEx in connection with the Consultation Paper for one or more of the following purposes:

- for performing HKEx's functions and those of its subsidiaries under the relevant laws, rules and regulations

- for research and statistical purposes

- for any other lawful purposes

Transfer of Personal Data

Personal Data collected may be disclosed by HKEx to members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper.

Access to or Correction of Data

You have the right to request access to and correction of your Personal Data in accordance with the provisions of the Personal Data (Privacy) Ordinance. If you wish to request access to and/or correction of your Personal Data provided in your submission on the Consultation Paper, you may do so in writing addressed to:

Personal Data Privacy Officer
Hong Kong Exchanges and Clearing Limited
11th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong
cvw@hkex.com.hk

HKEx has the right to charge a reasonable fee for processing any data access request.

PRIVACY POLICY STATEMENT

HKEx is firmly committed to preserving the privacy of respondents in relation to Personal Data supplied to HKEx on a voluntary basis. Personal Data may include names, addresses, e-mail addresses, login names etc. HKEx uses the information for the stated purposes when your Personal Data is collected. The Personal Data will not be used for any other purposes without your consent unless such use is permitted or required by law.

HKEx has security measures in place to protect the loss, misuse and alteration of the Personal Data of respondents. HKEx will strive to maintain Personal Data as accurately as reasonably possible and Personal Data will be retained for such period as may be necessary for the proper discharge of the function of HKEx and those of its subsidiaries.

ANNEX 5

SFC STATEMENTS OF POLICY ON PERSONAL DATA

PERSONAL INFORMATION COLLECTION STATEMENT

1. This Personal Information Collection Statement ("PICS") is made in accordance with the guidelines issued by the Privacy Commission for Personal Data. The PICS sets out the purposes for which your Personal Data[1] will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the PDPO.

General Policy Statement

2. The SFC pledges to meet fully recognised standards of personal data privacy protection in complying with the requirements of the PDPO. In doing so, the SFC will ensure compliance by its staff with the strictest standards of security and confidentiality.

Purpose of Collection

3. The Personal data provided in your submission to the SFC in response to the Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers ("the Consultation Paper") may be used by the SFC for one or more of the following purposes:

    - to administer the Securities and Futures Ordinance, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
    - for the purpose of performing the SFC's statutory functions under the Securities and Futures Ordinance
    - for research and statistical purposes
    - other purposes permitted by law

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[1] Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 ("PDPO")

Transfer of Personal Data

4. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

5. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

6. Personal Data provided to the SFC in response to the Consultation Paper is retained for such period as may be necessary for the proper discharge of the SFC's functions.

Enquiries

7. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

   The Data Privacy Officer
   The Securities and Futures Commission

   12/F, Edinburgh Tower **(on or before 30 June 2003)**
   The Landmark
   15 Queen's Road Central
   Hong Kong

   8th Floor, Chater House **(after 30 June 2003)**
   8 Connaught Road Central
   Hong Kong