



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

Consultation Paper on the regulation of sponsors

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Importance of sponsors

1. IPOs have fuelled the growth of Hong Kong's stock market over the last decade; it is now firmly established as the primary venue for Mainland China enterprises to raise funds outside domestic markets and has recently attracted significant listings from other international jurisdictions. The volume and frequency of IPOs has been a major component of Hong Kong's overall development as a leading international financial centre.
2. The health of any stock market is dependent on the confidence that investors have in the reliability and timeliness of information provided to them at the time a company first joins the market through an IPO and thereafter through the dissemination of periodic financial and other updates. In both cases the directors of a company are primarily responsible to investors to ensure that they are fully informed; directors have the deepest knowledge of the business and its prospects and are best placed to ensure that disclosure is accurate and meaningful. Their obligations to investors are contained in statute (such as the Securities and Futures Ordinance (**SFO**) and the Companies Ordinance), in the common law as well as in non-statutory provisions such as the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Listing Rules**).
3. Prior to an IPO a company is subject to a relatively light set of requirements governing corporate conduct and information disclosure; the IPO is transformative because it allows the company to access a range of institutional and retail investors on the basis that it complies with strict laws, rules and regulations all designed to ensure that the public can be confident in the governance of and disclosure made by the company.
4. The IPO itself is crucial; the listing document (which in this consultation refers to Companies Ordinance prospectuses as well as other types of listing documents) is the vehicle through which public investors are first given extensive information to enable them to form a judgment as to whether to apply for the company's securities. An IPO is the culmination of an intensive and collaborative process, with the directors performing a key role and taking primary responsibility for information in the listing document, but also involving reporting accountants, legal counsel, valuers and other experts as well as underwriters, sponsors and the regulators.
5. The role of sponsors is unique. The other experts and advisers referred to above are subject to a range of legal, regulatory and professional obligations and responsibilities, whereas only sponsors have a function that begins and ends with the IPO itself and in that capacity are specifically licensed by the SFC. Among other things they perform a lead role in co-ordinating all of those involved in the IPO process, they advise and guide directors throughout and they are centrally involved in the conduct of intensive due diligence on the company designed to ensure that the listing document contains sufficient information to ensure that public investors are in a position to form a valid and justifiable opinion on its business and prospects.
6. Investors rely on sponsors to act as key gatekeepers of market quality and at the heart of this lies the expectation that sponsors have conducted sufficient due diligence to properly understand and assess a company aspiring to join the stock market. The majority of companies wishing to do so have their management and major activities outside of Hong Kong and it follows that they have evolved within a legal, regulatory and business context that is different from that in Hong Kong. This means that an important element of due diligence is often concerned with gaining a full understanding of the local environment in which a company operates and determining how this should be reflected



in meaningful disclosure. Whilst this feature of Hong Kong IPOs requires special attention, it is nevertheless only one aspect of the overall requirement that sponsors must exercise care in client selection and in meeting the standards of work expected. Failure to do so can affect the quality of companies that are listed in Hong Kong and its overall reputation as a leading financial centre.

7. The SFC has been concerned that standards of sponsor work have fallen short of reasonable expectations. We have noted that in a number of cases sponsors did not substantially complete their due diligence before making a listing application which has meant that material misstatements, omissions and other deficiencies have affected draft listing documents. Furthermore, fundamental issues frequently only surface well after a listing application has been submitted, prolonging the regulatory review. These cases suggest that, without enquiries being made by the regulators, issues might not have been identified and important disclosures would have been omitted from the listing document. Failure to identify and address material disclosure and suitability issues on a timely basis increases the risk of a defective listing document and suggests that some sponsors over-rely on the regulatory commenting process.
8. We have also seen examples of sponsor work which has been carried out responsibly, deploying sufficient experience, expertise and management oversight to ensure that all relevant regulatory requirements are met and that investors are supplied with complete, accurate and well drafted disclosure. We do not expect that the proposals in this consultation would alter the way in which these sponsors operate. We do, however, believe that the proposals are important to provide a regulatory basis for defining the expected quality of sponsor work and as such are in the interests of public investors and all other stock market participants.



Summary of proposals

9. The proposals in this paper concern the conduct of sponsors in meeting their responsibilities in connection with new listings. Paragraphs 11 to 22 below outline the main proposals which relate to the SFC's licensing regime for sponsors. Some proposals consolidate existing rules and others are new. Paragraph 23 outlines our proposal concerning legal liability of sponsors under the Companies Ordinance.

SFC licensing regime

Code of conduct

10. We propose to aid clarity and enhance efficiency by consolidating all key sponsor obligations in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**).

Due diligence

11. We propose to specify that a sponsor should not submit a listing application to the regulators unless it has completed all reasonable due diligence on a listing applicant save only any matters that by their nature can only be dealt with later in the process. Whilst due diligence continues until the listing document is issued, the substantive part can and should be completed well before then.
12. We propose that a sponsor should not submit a listing application unless it is satisfied that the listing applicant is ready to be listed, in that any material deficiencies as to its operations and structure, procedures and systems and its directors and key senior managers have been remedied and it meets the listing qualifications. Similarly, a sponsor should not submit a listing application unless it is satisfied that the draft listing document submitted with the application is substantially complete and all material information is disclosed in this draft or otherwise brought to the attention of the regulators.
13. A sponsor needs to perform due diligence in order to gain a thorough knowledge and understanding of a listing applicant and to satisfy itself in relation to the disclosure in the listing document. Given that each listing applicant is unique, a sponsor must exercise careful judgement about the nature and extent of due diligence and the manner in which it should be performed; it would not be helpful to attempt to specify a complete list of due diligence steps that should apply in all circumstances as this would necessarily be incomplete and could encourage a "box ticking" mentality.
14. A sponsor should perform due diligence with an open and questioning mind recognizing that circumstances may exist that cause information to be materially misstated. A sponsor cannot accept at face value statements made and documents produced by a listing applicant but should ascertain the reliability of the information provided.

Reliance on experts

15. Sponsors should not place uncritical reliance on experts' work, including accountants' and valuers' reports. A sponsor has responsibility for all parts of a listing document, and accordingly we propose that it should be in a position to demonstrate that it is reasonable for it to rely on experts and their reports.



Reliance on non-expert third parties to conduct due diligence

16. Sponsors have increasingly sought to delegate due diligence work and responsibilities to others and in particular there are indications that sponsors may be over-relying on legal counsel in the due diligence process and as a result may not be fulfilling their own obligations. We remind all sponsors that, whilst it is open to them to seek assistance and assurances from third parties, they are ultimately responsible for due diligence and this responsibility cannot be delegated.

Information to regulators

17. The regulators place particular reliance on information provided by a sponsor during the listing application process, accordingly we propose that a sponsor should:
- (a) reasonably satisfy itself that all information provided to the regulators is accurate, complete and not misleading, and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the regulators promptly;
 - (b) disclose to the regulators any material information known to the sponsor relating to the applicant or the application concerning non-compliance with the Listing Rules or other legal or regulatory requirements; and
 - (c) notify the regulators why it ceased to act, if a sponsor ceases to act for an applicant during the listing application process.

Publication of first draft

18. To encourage the submission of quality listing documents which reflect a thorough understanding of the listing applicant and to enhance the efficiency of the application process, we propose that the first draft of the listing document submitted with a listing application is made available on the HKEx¹ website when the application is made.

Records

19. We propose that a sponsor maintains a record of the work it has done which is sufficient to demonstrate that it has complied with its responsibilities and that these records are kept for at least seven years in Hong Kong.

Resources, systems and procedures

20. A sponsor should maintain sufficient resources and effective systems and procedures to enable it to carry out its responsibilities. These should be designed to ensure that sufficient staff with requisite knowledge, skills and experience are devoted to a listing assignment and an appropriate due diligence plan is formulated, updated and implemented in respect of each listing assignment. It is also important that the senior management of a sponsor is able to monitor and guide the progress and standard of due diligence.

¹ Hong Kong Exchanges and Clearing Limited



Principals

21. We are aware of the difficulty sponsor firms can face in meeting the SFC's licensing requirements to have at least two members of staff with the qualifications to act as Principals². We therefore invite comments concerning the current licensing criteria and the ways in which these criteria might be amended in order to increase the number of individuals who may qualify as Principals whilst not affecting the overall quality of sponsor work.

Multiple sponsors

22. The appointment of multiple sponsors might be a factor contributing to unsatisfactory standards; this can lead to fragmentation of work, gaps and overlaps. From the perspective of investors there appears to be no benefit in having more than one sponsor. We therefore propose that either (i) a sole independent sponsor should be appointed for each listing transaction, or (ii) alternatively, there should be a limit on the number of sponsors that can be appointed for each listing transaction, each of whom should be independent of the listing applicant.

Prospectus liability

23. Sections 40 and 40A of the Companies Ordinance set out provisions dealing with civil liability and criminal liability for untrue statements, including a material omission, in a prospectus. We propose to make clear that a sponsor has civil and criminal liability under these provisions.
24. Whilst this paper focuses on the important responsibilities of sponsors, we would like to make clear that the SFC will not hesitate to take such action as may be available to it in the interests of investors against directors, experts and other persons under existing statutory provisions relevant to IPOs. These include sections of the SFO concerning the provision of false or misleading information³.

Invitation for comments

25. To assist the public, we have asked for responses to specific questions raised by the proposals. We also attach at **Appendix A** an indicative draft of a new paragraph 17 for inclusion in the Code of Conduct implementing our proposals.
26. We intend to implement the proposals concerning the non-statutory sponsor regulatory regime as soon as practicable. We will liaise with the Stock Exchange of Hong Kong Limited (**Stock Exchange**) as to any changes to the Listing Rules that may be required. Any final proposals to amend the prospectus liability provisions of the Companies Ordinance will be subject to consultation with the Administration as well as the legislative process, and will therefore follow a separate timetable.

² See the definition of Principal in the "Glossary" section of the draft Code of Conduct provisions at Appendix A.

³ Provisions include sections 277 and 298 regarding disclosure of false or misleading information inducing transactions and section 384 regarding provision to specified recipients, including the SFC, of false or misleading information in compliance with a requirement to do so by or under a relevant provision.



Background to proposals

27. Hong Kong was the world's largest IPO fund raising centre for three consecutive years up to and including 2011 and in that year 88 listings raised total funds of HK\$271 billion. It is now firmly established as the primary venue for Mainland China enterprises to raise funds outside domestic markets and has recently attracted significant listings from other international jurisdictions (e.g. Glencore International plc and PRADA S.p.A). The market capitalisation of companies from the Mainland and overseas now represents approximately 75% of the total. As discussed earlier, sponsors play a critical role in maintaining the quality and integrity of the IPO market.
28. In 2004, following a joint SFC and Stock Exchange consultation the Stock Exchange introduced new rules and procedures on the due diligence responsibilities of sponsors. In 2007 the SFC implemented a regulatory regime setting out additional requirements for eligibility and compliance specific to sponsors.
29. Notwithstanding these changes, the SFC remains concerned that standards of sponsor work can still fall short of reasonable expectations. Contributory factors may include:
 - (a) Resources – sponsors not developing sufficient resources or expertise to handle sponsor work and not devoting sufficient resources to individual engagements;
 - (b) Insufficient involvement of senior management – issues not being escalated to senior levels on a timely basis and insufficient oversight by senior management;
 - (c) Over-delegation to other parties (especially legal counsel) of responsibility for tasks that should fall under the purview of sponsors;
 - (d) Multiple sponsors – leading to fragmentation of work, gaps and overlaps;
 - (e) Uncritical reliance on experts, especially accountants and valuers.
30. The SFC has conducted routine inspections of sponsors from time to time. In 2011 the SFC concluded a theme inspection and issued a report detailing specific deficiencies in the work of sponsors. The SFC will continue with its programme of inspections to review the standard of due diligence performed by sponsors on selected IPO transactions and to monitor sponsors' establishment of, and compliance with, internal systems, controls and procedures. The SFC will take appropriate follow up action on any deficiencies identified, including requiring sponsors to take immediate corrective actions and to implement appropriate controls and measures to prevent recurrence. Where there are serious breaches, the SFC may commence investigative and disciplinary action.
31. Many listing documents suffer from:
 - (a) being too long;
 - (b) being difficult to read - written in legalistic or technical language paying insufficient attention to clear explanations written in plain language;
 - (c) their content being driven not by a desire to inform investors but by a desire to avoid liability;



- (d) having summaries that do not succinctly describe information contained elsewhere, rather they repeat lengthy elements from other parts of the document;
- (e) having risk factor sections that appear to repeat “boilerplate” disclosures included in many other listing documents with little or no effort made to describe the risks that are particularly relevant to the listing applicant; and
- (f) management discussion and analysis sections which refer to changes in figures from one year to the next with little meaningful explanation of the factors causing the change. Lengthy extracts of accounting policies from the financial statements are often included that in no obvious way assist investors’ understanding of the company.

32. Some market participants have mentioned that a contributing factor has been the transfer of responsibility for prospectus drafting from sponsors to legal counsel as well as an overreliance on the regulatory commenting process to improve poorly prepared documents submitted with the listing application. Whilst it is not for the SFC to determine who holds the pen when documents are drafted, we hope that one consequence of our proposed changes will be an increased emphasis by sponsors on taking substantive responsibility for the overall quality of listing documents from an early stage.
33. The way in which the market deals with the IPO process has over the years moved closer to the US model, in part because of international placings relying on Rule 144A or Regulation S under the US Securities Act and the associated use of “10-b-5” letters in a global offering⁴. Many of the characteristics of the US market which underpin that model are, however, absent in Hong Kong, including the widespread use in the US of investors’ private rights of action and class suits. We should also make clear that the verification process carried out by Hong Kong legal counsel, which involves checking the accuracy of listing document disclosure once drafted, is no substitute for the intensive due diligence required to assess suitability and to enable a quality draft listing document to be prepared at the outset. It follows that in Hong Kong there is a clear investor protection justification for a regulatory focus on sponsors to act as key gatekeepers of market quality and themselves to conduct sufficient, reasonable due diligence in every listing.
34. Failure to exercise due care in client selection and in meeting the standards of work expected from sponsors can directly impact the quality of companies that are listed on the Hong Kong stock market as well as its overall reputation. This in turn can affect the value placed by investors on individual listed companies, broader sectors or the equity market as a whole. It is therefore critical to ensure that investors can be confident in the quality of sponsors’ work so as to maintain Hong Kong’s reputation as a leading international financial centre. This paper sets out proposals for amending the SFC’s Code of Conduct and the Companies Ordinance with this goal in mind. Clearer standards for sponsors’ responsibilities underpinned by effective oversight are intended to create a more effective sponsor regime so as to maintain the quality and competitiveness of Hong Kong’s listed sector.

⁴ See paragraph 75 for further discussion on “10-b-5” letters.



Non-statutory sponsor regulatory regime

Role of sponsors

35. The Listing Rules describe the role of a sponsor principally in terms of the obligations of the sponsor towards the Stock Exchange. This is because the Stock Exchange and hence the investors rely on the work of sponsors to provide assurance that the listing applicant meets the requirements of the Listing Rules and, as set out in the Companies Ordinance, the prospectus⁵ provides sufficient particulars and information for investors to form a valid and justifiable opinion on the company's shares and its financial condition and profitability. It follows that the market relies heavily on the sponsor as a principal "gatekeeper" to protect investors. A sponsor also advises and guides the listing applicant as to the Listing Rules and other regulatory requirements. As stipulated in the Listing Rules, a listing applicant and its directors are obliged to assist the sponsor and other advisers to perform their roles. The sponsor's duty to advise the listing applicant does not in any way derogate from the obligations of the listing applicant and its directors under the Companies Ordinance, the Listing Rules and other legal and regulatory requirements concerning disclosure and other aspects of a listing.

Licensing

36. Sponsors must be licensed or registered under Type 6 Regulated Activity of the SFO. In addition, they must meet the eligibility criteria prescribed in the Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers (**Sponsor Guidelines**) in order to be permitted to undertake sponsor work as part of their Type 6 Regulated Activity.

Conduct

37. Sponsors are subject to:
- (a) the Code of Conduct, which sets out overall principles and requirements applicable to the conduct of all licensed and registered persons to which they must adhere in ensuring that they are fit and proper to remain licensed and registered;
 - (b) the Corporate Finance Adviser Code of Conduct (**CFA Code**) which provides specific conduct guidance to corporate finance advisers; and
 - (c) the Sponsor Guidelines, which set out continuing compliance requirements, including specific competence requirements as well as the responsibilities of management and sponsor principals.
38. Sponsors are also required to maintain proper systems, controls and procedures in accordance with the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**).

⁵ Generally a listing document is a prospectus that has to meet the requirements of the CO. In some cases, such as a listing by means of an introduction, the listing document is not a prospectus. In these cases the Companies Ordinance standard is still applied.



Listing Rules

39. A sponsor is required to comply with the requirements of Chapter 3A and Practice Note 21 (**PN 21**) of the Listing Rules⁶ when acting as a sponsor to a listing applicant. PN 21 contains detailed guidance on sponsors' due diligence obligations.

Code of Conduct

40. A sponsor must have regard to a number of scattered codes and guidelines to ensure it discharges its role satisfactorily, including those referred to in paragraphs 36 to 39. We believe that it would aid clarity and enhance efficiency to consolidate all key obligations in a centralised code.
41. The SFC therefore proposes to set out the key standards and requirements for sponsor conduct in a new paragraph 17 of the Code of Conduct (**Provisions**). The general principles already contained in the Code of Conduct will continue to apply to sponsors as they do for all licensed or registered persons.
42. Some of the Provisions are new whilst others have been sourced from the Code of Conduct, the CFA Code, the Listing Rules, the Sponsor Guidelines and the Internal Control Guidelines.
43. To avoid duplication and inconsistency we will remove as far as practicable requirements that are to be dealt with in the proposed Provisions from the CFA Code, the Sponsor Guidelines and other relevant codes and guidelines. We will also work with the Stock Exchange to modify the equivalent provisions in the Listing Rules to dovetail with the proposed Provisions. The Provisions should therefore provide a centralised source of guidance for sponsor conduct⁷.
44. In the following paragraphs we highlight the key aspects of the proposed Provisions, the draft text of which is at **Appendix A**.

Advising a listing applicant (paragraph 17.3⁸)

45. Under the "know your client" requirement of the CFA Code⁹, unless the circumstances do not require, a corporate finance adviser should understand the business of its client, in particular, its background, the nature of its business and the financial circumstances and investment objectives in relation to the transaction under consideration. Based on the existing "know your client" requirement and in the context of a listing application, **the proposed Provisions require that a sponsor should have a sound understanding of a listing applicant, including its history and background, business and performance, financial condition and prospects, operations and structure, procedures and systems, as well as the directors, key senior managers and (where applicable) controlling shareholders of the listing applicant (Proposal 1¹⁰).**

⁶ References to the Main Board Listing Rules in this paper should be taken to cover the equivalent GEM Listing Rules.

⁷ There are other codes and guidelines which principally deal with matters other than conduct. The Sponsor Guidelines set out the licensing requirements and other continuous compliance requirements for sponsors. The Internal Control Guidelines provide guidance to licensed or registered persons in relation to internal systems, procedures and controls.

⁸ The paragraph numbering corresponds to that of the draft Code of Conduct provisions attached at Appendix A.

⁹ See paragraph 6.1 of the CFA code.

¹⁰ The proposal numbering corresponds to that of the Summary of proposed Provisions and applicable sources attached at Appendix B.



**Q1. Do you agree a sponsor should have a sound understanding of a listing applicant for which it acts?
If not, why not?**

46. Under the CFA Code, a corporate finance adviser should use all reasonable efforts to ensure that its client understands the relevant regulatory requirements and their implications at all stages of a transaction¹¹. In the context of a listing application, **we propose to clarify this principle by prescribing that a sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements and take all reasonable steps to ensure that at all stages of the listing application process they understand and meet these responsibilities. Moreover, the sponsor should provide appropriate advice and recommendations to the listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers and ensure that any material deficiencies are remedied prior to the submission of a listing application (Proposal 2).**

**Q2. Do you agree that a sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements and take all reasonable steps to ensure that at all stages of the listing application process they understand and meet these responsibilities?
If not, why not?**

**Q3. Do you agree that a sponsor should provide appropriate advice and recommendations to a listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers and ensure that any material deficiencies are remedied prior to the submission of a listing application?
If not, why not?**

Work required before submitting a listing application (paragraph 17.4)

Completion of reasonable due diligence

47. Under the Listing Rules¹², the Stock Exchange expects to receive an advanced proof (**Application Proof**) of the listing document with the listing application form so that the Stock Exchange's review can commence immediately. The Stock Exchange expects that the information specified by the Listing Rules for inclusion in a listing document must be substantially complete in the Application Proof.
48. The SFC has noted that in a number of cases sponsors did not substantially complete their due diligence before making a listing application. As detailed in the SFC's Dual

¹¹ See paragraph 6.3 of the CFA Code.

¹² See rule 9.03(3) of the Listing Rules.



Filing Updates¹³, in many cases material misstatements, omissions and other deficiencies have affected Application Proofs and as mentioned earlier, fundamental issues frequently only surface well after a listing application has been submitted.

49. Under the Listing Rules, at the time of issue of a listing document, a sponsor is required to conduct reasonable due diligence inquiries in order to make a declaration (**Declaration**) to the Stock Exchange that a listing applicant fulfils principal listing requirements. The declaration covers:
- (a) compliance with the qualifications for listing (except to the extent that compliance has been waived);
 - (b) sufficiency of particulars and information in the listing document to enable a reasonable person to form a valid and justifiable opinion of the shares and the financial condition and profitability of the applicant;
 - (c) the truthfulness of the information in the non-expert sections of the listing document with no material omissions;
 - (d) the establishment of adequate procedures and systems to ensure the applicant complies with the relevant regulatory requirements and to enable the directors to make a proper assessment of the financial position and prospects of the applicant; and
 - (e) the appointment of experienced, qualified and competent directors¹⁴.
50. Although the Declaration is required to be made at the time of issue of a listing document, the Stock Exchange expects that a sponsor should have completed substantive due diligence at an early stage.
51. The SFC believes that only requiring the Declaration to be made at the time of issue of the listing document may have encouraged some sponsors to delay substantive due diligence until well after the submission of the listing application.
52. To ensure that substantive due diligence is completed and documents submitted with an application are of a sufficient standard to enable regulators to commence a proper review, **we propose that before submitting a listing application a sponsor should complete all reasonable due diligence on the listing applicant save only any matters that by their nature can only be dealt with at a later date** (e.g. where transactions take place or there are material developments in the company's business subsequent to the submission of the listing application) (**Proposal 3**). Whilst due diligence continues until the listing document is issued, including the exercise known as "bring down" diligence to check prior disclosures and conclusions, the substantive part can and should be completed before the application is submitted.

¹³ The SFC issues a regular update on the operation of the dual filing arrangement which discusses major compliance and disclosure issues on listing applications.

¹⁴ See rule 3A.15 of the Listing Rules.



Q4. Do you agree that before submitting a listing application a sponsor should complete all reasonable due diligence on the listing applicant save only any matters that by their nature can only be dealt with at a later date?

If not, why not?

53. We also propose to codify the current expectation in the Listing Rules concerning the quality of the Application Proof by requiring that **before submitting a listing application a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete (Proposal 4)**. As noted in paragraph 84 below, we propose that the Application Proof should be made available on the HKEx website when the application is made.

Q5. Do you agree that before submitting a listing application a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete?

If not, why not?

Resolving fundamental compliance issues

54. The SFC and the Stock Exchange take the view that a sponsor should consider and resolve issues concerning eligibility criteria, internal systems and controls and the credentials of directors before making a listing application. It is not appropriate to deal with these essential matters only during the listing application process as they are relevant to overall suitability.
55. In the UK, a sponsor must not submit a listing application to the Financial Services Authority (**FSA**) unless it comes to a reasonable opinion, after due and careful enquiry, that the listing applicant has fulfilled all applicable listing requirements and that the directors have established procedures which enable the applicant to comply with all relevant requirements and which provide a reasonable basis for the directors to make a proper judgement on an ongoing basis as to the applicant's financial position and prospects¹⁵.
56. **We propose that, before submitting a listing application a sponsor should come to a reasonable opinion that:**
- (a) the applicant has complied with all applicable listing conditions (except to the extent that waivers from compliance have been applied for) (see paragraph 49(a));**
 - (b) the applicant has established adequate systems and procedures to ensure compliance with the Listing Rules and other applicable legal and regulatory requirements and enable its directors to make a proper assessment of the applicant's financial condition and prospects (see paragraph 49(d)); and**

¹⁵ See rule 8.4.2 of the FSA Listing Rules.



- (c) the directors have the necessary experience, qualifications and competence (see paragraph 49(e))(Proposal 5).

Q6. Do you agree that before submitting a listing application a sponsor should come to a reasonable opinion that the applicant has complied with all applicable listing conditions (except to the extent that waivers from compliance have been applied for), has established adequate systems and procedures and the directors have the necessary experience, qualifications and competence?

If not, why not?

Identifying material issues

57. The regulators commence a review of a listing application based on disclosure made in the Application Proof and taking account of any other written submissions made by a sponsor on behalf of a listing applicant. Under the Listing Rules, the Stock Exchange must be satisfied that the listing applicant is suitable for listing. Under the Securities and Futures (Stock Market Listing) Rules, the SFC may object to a listing if it appears that, among other things, it would not be in the interest of the investing public or in the public interest for the securities to be listed. In order that the regulators have all relevant information to consider these matters, a sponsor is obliged to identify and bring to the attention of the regulators all material issues and risks that may affect the regulators' opinion at the outset of the listing application process. Accordingly, **we propose that a sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of whether the listing applicant is suitable for listing and whether the listing of the applicant's securities is contrary to the interest of the investing public or to the public interest are disclosed to the regulators when submitting a listing application (Proposal 6).**
58. This proposal is similar to the UK approach where a sponsor must ensure that all matters known to it which in its reasonable opinion should be taken into account by the FSA in considering the listing application and whether the listing of the applicant's securities would be detrimental to investors' interests be disclosed prominently in the first draft of the prospectus or equivalent document or otherwise in writing to the FSA¹⁶.

Q7. Do you agree that a sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of the application as described in paragraph 57 above are disclosed to the regulators when submitting a listing application?

If not, why not?

Sponsor's responsibility for disclosure in a listing document (paragraph 17.5)

Overall disclosure

59. As noted above, the Declaration requires a sponsor to confirm that a listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of a listing applicant

¹⁶ See rule 8.4.3(3) of FSA Listing Rules.



at the time of issue of the listing document (see paragraph 49(b)). This provision is substantially similar to the requirements of paragraph 3 of the Third Schedule to the Companies Ordinance concerning prospectus disclosure. This is a key obligation, and we propose that it is replicated and reinforced in the Code of Conduct. Accordingly, **the proposed Provisions require a sponsor, after reasonable due diligence, to ensure that at the time of issue a listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant (Proposal 7).**

Q8. Do you agree that a sponsor, after reasonable due diligence, should ensure that at the time of issue a listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant?
If not, why not?

Disclosure: non-expert sections

60. Listing documents include an accountants' report and in some cases reports by other experts, for example valuers. These are generally known as **expert reports** and collectively as the **expert sections**. The remaining information, which usually consists of the majority of a listing document, is contained in the **non-expert sections**.
61. The Declaration obliges a sponsor to make a confirmation as to the truthfulness and completeness of the information in the non-expert sections (see paragraph 49(c)), which together comprise key disclosure. These include the industry overview, the history and pre-listing reorganisation of the listing applicant, a business description, a management discussion and analysis of financial information, a description of the use of proceeds and risk factors.
62. Sponsors have a central role to play in relation to non-expert sections in light of their coordinating function in the listing exercise, their financial and sector expertise and access to a wide range of management and market information. This is reflected in a key Listing Rules obligation for sponsors to ensure the truth, accuracy and completeness of the non-expert sections. We propose that this is replicated and reinforced in the Code of Conduct. Accordingly, **the proposed Provisions require that a sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that at the time of issue of a listing document the information in the non-expert sections is true, accurate and complete in all material respects and that there are no material omissions (Proposal 8).**

Q9. Do you agree that a sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that at the time of issue of a listing document the information in the non-expert sections is true, accurate and complete in all material respects and that there are no material omissions?
If not, why not?



Disclosure: expert sections

63. Under the Listing Rules, a sponsor is not required to give a confirmation with respect to information in the expert sections. Instead the sponsor is required to confirm specific matters relating to the preparation of expert reports, namely, that the expert is appropriately qualified and experienced, the bases and assumptions adopted by the expert are fair and reasonable, the expert's scope of work is appropriate to the opinion and the expert is independent from the listing applicant. The sponsor must also ensure that the factual information used or relied on by the expert is true in all material respects and does not omit any material information where the expert does not conduct its own verification of material factual information¹⁷
64. Information in an expert report is significant to the overall preparation of a listing document; it often is relevant to the information disclosed in the non-expert sections and an expert opinion or valuation usually comprises important information for investors. Serious consequences may arise if an expert report is subsequently found to be false or misleading; for example, where financial information is found to be incorrect, an asset valuation is overstated or legal advice is flawed. In light of this it is desirable to provide a clearer standard concerning sponsors and disclosure in expert reports.
65. A sponsor is not required to perform the work of an expert, or to address issues which only an expert possessing specialised knowledge and qualifications is equipped to deal with. For example, a reporting accountant is required to subject information received from a listing applicant to appropriate audit procedures, including underlying accounting records and supporting information, sufficient for the reporting accountant to reach an opinion on the financial statements. Accordingly, a sponsor is not expected to repeat the work of the reporting accountant on the financial statements. Nevertheless, a sponsor should satisfy itself that it is reasonable to rely on the expert's report or opinion, taking into account its own in-depth and wide-ranging knowledge of the listing applicant accumulated since the point at which the sponsor was first engaged by the applicant, whether formally or informally. If the sponsor has any information (including the history of the applicant, the markets in which it operates and its business model) which may impact on the accuracy and completeness of any expert report, or any information in any expert report is of relevance to the accuracy or completeness of other information relied on by the sponsor in preparing the applicant for listing, it is essential that the sponsor makes further enquiries.
66. The standard we expect of a sponsor as regards expert reports is similar to that under Australian law which provides for a "reasonable reliance" defence where a person, including an underwriter, will not be liable for a misstatement or an omission in a disclosure document if the person proves that it placed reasonable reliance on information given to it by someone else¹⁸. Under US law an underwriter is absolved from liability if it proves that it had no reasonable ground to believe, and did not believe, that the statements in expert reports were untrue or there were material omissions¹⁹.

¹⁷ See rule 3A.16 of the Listing Rules.

¹⁸ Subsection 733(1) of the Australian Corporations Act 2001 states that a person does not commit an offence against subsection 728(3), and is not liable under section 729 for a contravention against subsection 728(1), because of a misleading or deceptive statement in, or an omission from, a disclosure document if the person proves that they placed reasonable reliance on information given to them by (a) if the person is a body – someone other than a director, employee or agent of the body; or (b) if the person is an individual – someone other than an employee or agent of the individual.

¹⁹ Section 11 of the US Securities Act states that (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue – ... (5) every underwriter with



US case law stresses that an underwriter's reliance on expert statements cannot be "blind". Where red flags about the reliability of expert statements emerge, continued reliance on an expert's report will not be sufficient to avoid liability²⁰.

67. It might be argued that a sponsor which relies in good faith on information in an expert report should not be held responsible given that the sponsor is not itself an expert and the sponsor should be entitled to rely on the professional expertise of the expert. However, from an investor protection perspective, we do not believe that it would be desirable to allow a sponsor to rely on an expert report when the sponsor has not acted reasonably in doing so.
68. To emphasize and clarify a sponsor's obligation in respect of expert reports and taking account of "reasonable reliance" concepts contained in Australian and US law, **we propose to introduce a requirement that at the time of issue of a listing document a sponsor should be in a position to demonstrate that it is reasonable for it to rely on the expert sections of the listing document (Proposal 9)**. Paragraph 73 discusses typical due diligence steps a sponsor should take for this purpose.

Q10. Do you agree that at the time of issue of a listing document a sponsor should be in a position to demonstrate that it is reasonable for it to rely on the expert sections of the listing document?

If not, why not?

Due diligence (paragraph 17.6)

69. The Listing Rules contain detailed requirements on the roles and responsibilities of sponsors when acting for listing applicants. Chapter 3A requires that a sponsor conducts "reasonable due diligence inquiries" before making the Declaration to the Stock Exchange referred to in paragraph 49. PN 21 sets out examples of due diligence steps the Stock Exchange expects sponsors would typically perform.
70. The proposed Provisions incorporate general principles from PN 21 and include additional guidance in areas where the need to pursue specific lines of enquiry are commonly encountered.
71. In line with the current requirements the proposed Provisions require that a sponsor should perform "reasonable due diligence" in order to gain a thorough knowledge and understanding of a listing applicant and to satisfy itself in relation to the disclosure in the

respect to such security. (b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof – ... (3) that... (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert.

²⁰ See pages 30 to 32 of the case report *In re WorldCom, Inc. Sec. Litigation*, 346 F. Supp. 2d 628; 2004 U.S. Dist. LEXIS 25155 dated December 15, 2004. In the section headed Reliance Defense, the defendant underwriters had argued that they had a reliance defense under section 11 in relation to WorldCom's audited financial statements. However, the court took the view that underwriters' reliance on audited financial statements may not be blind. Where red flags regarding the reliability of an audited financial statement emerge, mere reliance on an audit will not be sufficient to ward off liability. For example, red flags can be those facts which come to a defendant's attention that would place a reasonable party in the defendant's position "on notice that the audited company was engaged in wrongdoing to the detriment of its investors." In rejecting the argument of the underwriters, the court found that disputed facts suggested red flags existed that should have caused the underwriters to question the reliability of WorldCom's audited financial statements and conduct further investigation.



listing document and the Application Proof. Given that each listing applicant is unique, the proposed Provisions require a sponsor to exercise reasonable judgement about the nature and extent of due diligence appropriate to a particular listing applicant; as with PN21 it is not possible to specify a complete list of due diligence steps that would apply in all circumstances.

72. The proposed Provisions stress that a sponsor should perform due diligence with an attitude of professional scepticism recognizing that circumstances may exist that cause information to be materially misstated. A sponsor cannot accept at face value statements made and documents produced by a listing applicant but should seek to ascertain the reliability of the information provided.

Due diligence on work of experts

73. **The proposed Provisions set out typical steps a sponsor should take in order for a sponsor to demonstrate that it is reasonable for it to rely on an expert report. These include, among other things:**
- (a) the sponsor confirming that the expert is appropriately qualified and experienced, the bases and assumptions adopted by the expert are fair and reasonable, the experts' scope of work is appropriate to the opinion and the expert is independent from the listing applicant;**
 - (b) the sponsor ensuring that factual information on which an expert relies is consistent with the sponsor's knowledge of the applicant including that derived from its other due diligence work;**
 - (c) where factual information is solely or primarily derived from management's representations and confirmations, the sponsor, unless the expert has done so, making independent inquires or assessments or obtaining independently sourced information to verify the accuracy and completeness of the information; and**
 - (d) the sponsor corroborating information obtained from different sources to ensure that it is consistent (Proposal 10).**

<p>Q11. Do you agree that the sponsor should take these steps in connection with an expert report? Are the steps set out in paragraph 17.6(g) of the draft Provisions sufficient and appropriate?</p> <p>If not, why not?</p>

Reliance on non-expert third parties to conduct due diligence

74. "Experts" in the context of a listing document is a term usually applied to the professionals responsible for an expert report as described in paragraph 60 above. Other professionals, in particular legal counsel, may be intimately involved in the listing process without being responsible for an expert report. The sponsor may need to rely on legal expertise as part of its due diligence; for instance a sponsor relies on legal advice and opinions on title to properties and other proprietary rights as well as in connection with the validity and enforceability of underwriting agreements and other legally effective transactions relevant to a listing. These matters are clearly within the core competency of legal counsel. However much of the subject matter covered by



due diligence lies outside the ambit of legal advice or opinion including an understanding of business models and the market in which a listing applicant operates. In seeking the assistance of legal counsel or other professionals, a sponsor should carefully distinguish between matters that fall within that person's professional competency and those that do not. We are particularly concerned that sponsors may be over-delegating their responsibilities to conduct due diligence.

75. We also understand that in an increasing number of cases sponsors have asked legal counsel to provide comfort letters relating to due diligence requirements in Hong Kong, similar to "10-b-5" letters²¹ provided in connection with listings in the US, where it has been customary not to retain records of due diligence work. As the only regulatory obligation in Hong Kong to conduct due diligence rests with the sponsor and a record of work done must be kept, we do not consider that the existence of such a letter can have any bearing on whether a sponsor has in fact met its obligations. Indeed this might in some cases give rise to concerns that a sponsor has over-relied on legal counsel during the due diligence process, and as a result has not met its obligations to conduct reasonable due diligence.
76. The proposed Provisions deal with the obligations of a sponsor when working with third parties, including professionals such as legal counsel, making clear that a sponsor cannot delegate its responsibility for due diligence. This does not mean that in all circumstances it would not be appropriate for a sponsor to seek assistance from a third party. It is often the case that relevant and appropriate professional input is valuable – for example, the use of accounting firms and others to assist in reviews of the listing applicant's internal controls is common practice. We also recognise that legal counsel who are capital markets specialists will often have developed general experience and expertise which can be brought to bear in collaboration with sponsors to assist in the due diligence exercise, and, as mentioned above, law firms routinely "hold the pen" when listing documents are drafted, conduct verification and issue "10-b-5" letters. **Nevertheless, a sponsor remains responsible for the overall due diligence exercise. In particular a sponsor should:**
- (a) **assess whether a third party is appropriately qualified and competent for the tasks assigned to it;**
 - (b) **determine the scope and extent of tasks to be performed by the third party;**
 - (c) **assess the results of the work performed by the third party and arrive at its own opinion whether the work provides a sufficient basis to determine that reasonable due diligence has been conducted and whether further due diligence is required; and**
 - (d) **assess whether the results of the work should be incorporated in the listing document or brought to the attention of regulators (Proposal 11).**

²¹ A 10-b-5 letter is a fairly standard statement by US counsel that "upon reviewing the offering circular, and having conducted business and documentary due diligence, nothing has come to their attention to suggest that the offering circular contains any untrue statement of a material fact or fails to state a material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading."



Q12. Do you agree that a sponsor cannot delegate responsibility for due diligence?

If not, why not?

Q13. Are the steps we propose a sponsor should take when seeking assistance from a third party in its due diligence work sufficient and appropriate?

If not, why not?

Communications with the regulators (paragraph 17.7)

77. During the listing application process, sponsors are responsible to both the Stock Exchange and the SFC. When a sponsor submits a listing application to the Stock Exchange, the application documents are deemed to be filed with the SFC under the dual filing arrangement²². This streamlines the listing application process by ensuring that documents only need to be filed physically with the Stock Exchange.
78. The Stock Exchange and the SFC will review the listing application based on representations made, and information submitted, by a sponsor on behalf of a listing applicant. The sponsor should exercise due care and diligence in respect of all representations and information submitted by or through it. The provision of accurate and complete information to regulators during the listing application process is essential for the integrity of the market.
79. Under the Listing Rules²³, a sponsor must use reasonable endeavours to ensure that all information provided to the Stock Exchange during the listing application process is true in all material respects and does not omit any material information and, if the sponsor subsequently becomes aware of information that casts doubt on the truth and accuracy of the information provided to the Stock Exchange, it will promptly inform the Stock Exchange. The provision of false and misleading information to the Stock Exchange and the SFC during the listing application process may attract criminal liability under section 384 of the SFO.
80. Consistent with the current requirements and general principle 2 of the Code of Conduct, **the proposed Provisions state that a sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and the SFC during the listing application process is accurate, complete and not misleading and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the Stock Exchange and the SFC (as the case may be) promptly. In addition, a sponsor should deal with all enquires raised by the regulators in a cooperative, truthful and prompt manner so as to ensure smooth processing of the listing application (Proposal 12).**

²² Under the dual filing arrangement, a listing applicant is regarded to have filed the information to the SFC if the applicant submits the information to the Stock Exchange and authorises the Stock Exchange to file the information with the SFC.

²³ See rule 3A.04(2) of the Listing Rules.



Q14. Do you agree that a sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and the SFC during the listing application process is accurate, complete and not misleading and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform them promptly?

If not, why not?

Q15. Do you agree that a sponsor should deal with all enquires raised by the regulators in a cooperative, truthful and prompt manner?

If not, why not?

81. Under the CFA Code, where a sponsor becomes aware that a listing applicant is not in compliance with any relevant regulatory requirement, it is required to advise the listing applicant to bring the matter to the attention of the regulators at the earliest opportunity²⁴. The CFA Code however does not impose a specific obligation on a sponsor itself to inform the regulators of non-compliance. The obligation on a sponsor only arises when it is contacted by the regulators, whereupon it is required to respond in a cooperative and truthful manner to the best of its knowledge²⁵.
82. If a sponsor has identified or is suspicious of material non-compliance issues but has chosen to cease to act and not to inform the regulators, these issues may not surface and this may lead to serious disclosure deficiencies. Accordingly, **we propose that a sponsor should disclose to the Stock Exchange in a timely manner any material information relating to a listing applicant or listing application of which it becomes aware which concerns non-compliance with the Listing Rules or other applicable legal or regulatory requirements. If a sponsor ceases to act for a listing applicant during the listing application process, it is required to inform the Stock Exchange in a timely manner of the reasons for ceasing to act (Proposal 13).**
83. This proposal is similar to the requirement in the UK where a sponsor must promptly inform the FSA of any material information relating to a listing applicant of which it has knowledge which concerns non-compliance with relevant regulatory requirements²⁶.

Q16. Do you agree that a sponsor should disclose to the Stock Exchange in a timely manner any material information relating to a listing applicant or listing application of which it becomes aware which concerns non-compliance with the Listing Rules or other applicable legal or regulatory requirements?

If not, why not?

²⁴ See paragraph 6.3 of the CFA Code.

²⁵ See paragraph 6.3 of the CFA Code.

²⁶ Rule 8.3.5A of the FSA Listing Rules states that a sponsor must in relation to a sponsor service disclose to the FSA in a timely manner any material information relating to the sponsor or to a listed company or applicant of which it has knowledge which concerns non-compliance with the listing rules or disclosure rules and transparency rules.



Q17. Do you agree that if a sponsor ceases to act for a listing applicant during the listing application process, it is required to inform the Stock Exchange in a timely manner of the reasons for ceasing to act?
If not, why not?

Publication of Application Proof

84. To improve the quality of listing documents and to enhance the efficiency of the listing application process, **we propose that the Application Proof submitted with a listing application is made available on the HKEx website when the application is made.** Public exposure is intended to encourage the submission of a high quality and substantially complete first submission draft which reflects a thorough understanding of the listing applicant. If this proposal proceeds we will work with the Stock Exchange to make appropriate amendments to the Listing Rules.
85. There may be concerns about whether a published Application Proof constitutes a prospectus. As is the case for a WPIP²⁷ (which is also published before a prospectus is issued), and for the reasons set out in the Joint Policy Statement concerning WPIPs issued in 2007, we are satisfied that publication will not mean that the Application Proof could be considered to be a prospectus, an extract from or abridged version of a prospectus, an advertisement in relation to a prospectus or proposed prospectus under the Companies Ordinance, or a prohibited advertisement under the SFO. Publication is broadly in line with the practice of making public drafts of listing documents submitted during the listing process in the United States.

Q18. Do you agree that the Application Proof submitted with a listing application should be made publically available when the application is made?
If not, why not?

Proper records (paragraph 17.8)

86. The CFA Code requires that a corporate finance adviser should maintain proper books and records, and be able to provide a proper trail of work done upon request by the SFC²⁸. Under the Listing Rules, the Stock Exchange expects sponsors to document their due diligence planning and significant deviations from their plans, as well as conclusions it has reached in respect of the listing applicant's compliance with listing conditions²⁹.
87. In carrying out inspections of sponsor activities, the SFC has noted that a number of sponsors have failed to maintain proper documentation and records of their due diligence work. For example, sponsors have recorded the fact that a meeting or telephone discussion has taken place, but have not kept any detailed notes on the actual

²⁷ For details of a WPIP (Web Proof Information Pack), please refer to a joint policy statement issued by the SFC and Stock Exchange on the Pilot Scheme Regarding the Posting of a Web Proof Information Pack on the HKEx Website Prior to the Issue of a Prospectus in IPO Cases dated 5 November 2007.

²⁸ See paragraph 2.3 of the CFA Code.

²⁹ See paragraph 4 of Practice Note 21 of the Listing Rules.



discussions including the rationale for decisions made. In other cases, where significant issues arose in the course of the listing application but which were disposed of without any disclosure being made in the listing document, no documentation was kept to record how these issues were identified and resolved. There are other examples of deficient record keeping.

88. We take the view that a sponsor should maintain adequate records to demonstrate that it has performed proper due diligence and has turned its mind to the question of what inquiries are necessary and reasonable.

89. **The proposed Provisions require a sponsor to maintain adequate records in relation to the sponsor's work. These records should be sufficient to demonstrate that the sponsor has complied with all applicable legal and regulatory requirements and in particular compliance with the Provisions (Proposal 14).**

**Q19. Do you agree that a sponsor's records should be sufficient to demonstrate that the sponsor has complied with all applicable legal and regulatory requirements and in particular compliance with the Provisions?
If not, why not?**

90. **The proposed Provisions state that a complete set of a sponsor's records in connection with a listing transaction should be retained in Hong Kong for at least seven years after completion or termination of the transaction (Proposal 15).**

**Q20. Do you agree that a complete set of a sponsor's records in connection with a listing transaction should be retained in Hong Kong for at least seven years after completion or termination of the transaction?
If not, why not?**

Resources, systems and procedures (paragraph 17.9)

91. The Code of Conduct³⁰ provides that a licensed or registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities. Part 1 of the Internal Control Guidelines provides that Management³¹ should ensure that there is an effective management and organisational structure which ensures that the operations of the business are conducted in a sound, efficient and effective manner. Management should assume full responsibility for the firm's operations including the development, implementation and on-going effectiveness of the firm's internal controls and adherence to them by its directors and employees. Reporting lines should be clearly identified, with supervisory and reporting responsibilities assigned to appropriate staff members.

92. In carrying out inspections of sponsors, common deficiencies have been found in sponsors' monitoring of the implementation of the due diligence plan, reviewing the type,

³⁰ See General Principle 3 of the Code of Conduct.

³¹ See the definition of Management in the "Glossary" section of the draft Code of Conduct provisions at Appendix A.



standard and extent of due diligence and the performance of Principals and other staff, and providing supervisory guidance in handling more difficult or sensitive situations.

Sufficient resources

93. Standards of sponsor work depend on the resources devoted to individual assignments and the amount and quality of senior management involvement at appropriate stages during each assignment. As discussed above, two factors that may be contributing to unsatisfactory standards are:

- (a) a lack of resources and expertise within firms and failure to devote sufficient resources to individual engagements; and
- (b) insufficient involvement of senior management.

94. The resources to be devoted to sponsor work is a matter of each firm to determine. It is not for the regulators to seek to specify in detail what is required beyond the minimum specified to obtain and retain a license. It is for Management of each firm to ensure that it has sufficient resources to handle the engagements it takes on and it has staff with appropriate levels of experience and expertise to undertake each new assignment. Accordingly, **the proposed Provisions include an obligation for a firm to ensure that, before accepting any appointment as a sponsor, taking account of other commitments, it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment throughout the period of the assignment (Proposal 16).**

Q21. Do you agree that before accepting any appointment as a sponsor, a firm should ensure that, taking account of other commitments, it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment throughout the period of the assignment?

If not, why not?

95. The Sponsor Guidelines³² state that Management should appoint a team comprising corporate finance staff (**Transaction Team**) with at least one Principal, with appropriate skills and expertise, to carry out each sponsor engagement having regard to the size, complexity and nature of the sponsor work required to be undertaken. To consolidate all existing provisions concerning resources in respect of a sponsor engagement, **we propose transferring the relevant provisions from the Sponsor Guidelines to the Code of Conduct. The transferred provisions will be deleted from the Sponsor Guidelines (Proposal 17).**

Q22. Do you agree that the provisions of the Sponsor Guidelines concerning the Transaction Team should be transferred to the Code of Conduct?

If not, why not?

³² See paragraphs 1.1.3, 1.1.6, 1.2.4 and 1.2.5 of the Sponsor Guidelines.



Due diligence plan

96. To ensure proper implementation of the due diligence plan and use of appropriate reporting lines to Management, **a sponsor should maintain effective systems and procedures to ensure that an appropriate due diligence plan is formulated, updated as necessary and implemented in respect of each assignment and there are clear and effective reporting lines so that key issues are escalated to Management for deliberation (Proposal 18).**

Q23. Do you agree that a sponsor should maintain effective systems and procedures to ensure that an appropriate due diligence plan is formulated, updated as necessary and implemented in respect of each assignment and there are clear and effective reporting lines to ensure that key issues are escalated to Management for deliberation?
If not, why not?

Management oversight

97. It is essential that Management has adequate oversight over the due diligence exercise. In particular, Management should monitor the progress and standard of due diligence performed by the Principal and the Transaction Team and, where more difficult or sensitive situations are encountered, provide substantive input as well as directing the overall management of the transaction. **The proposed Provisions include an obligation for Management to assume full responsibility for the sponsor's operations and to supervise key issues including but not limited to:**
- (a) **accepting a mandate to act as a sponsor;**
 - (b) **monitoring the implementation of the due diligence plan;**
 - (c) **ensuring that sufficient persons with appropriate levels of knowledge, skills and experience are devoted to each assignment over the period of the assignment;**
 - (d) **reviewing the standard and extent of due diligence work, and the performance of the Principals and the Transaction Team; and**
 - (e) **resolving suspicious circumstances, difficult or sensitive issues, conflicting information and material non-compliance (Proposal 19).**

Q24. Do you agree that a sponsor's Management is obliged to adequately supervise the performance of due diligence including but not limited to the key issues discussed in paragraph 97?
If not, why not?

98. In almost all cases firms that act as a sponsor provide other services in connection with the listing, in particular by underwriting the share offer. Typically the fees received from a listing consist of the underwriting commission, being a percentage of the amount underwritten, and the sponsor fee, generally a fixed amount billed in stages. In some cases the sponsor fee reflects neither the amount of work required of a sponsor nor the



responsibilities associated with being a sponsor. We understand that firms generally consider their work on a listing as an omnibus assignment even though it comprises different services provided by different corporate finance specialists.

99. In our view the sponsor's role is crucial and should be recognized as such in fees charged. By not allocating an appropriate amount of the overall fee to the sponsor's role, firms risk sending a signal to their staff and their clients that the sponsor's role is less important and relevant than the bookbuilding, pricing and other services provided in connection with a listing which may in turn contribute to standards in some sponsors falling below expectations. Accordingly we encourage all firms to ensure that an appropriate portion of the total fee is designated as the sponsor fee. We also consider that "no deal; no fee" arrangement, whether implicit or explicit, can lead to misalignment of incentives for staff and should be avoided. In all cases Management needs to ensure that fee arrangements do not in any way inhibit the work of a sponsor.

Sponsor Principals

100. The Sponsor Guidelines prescribe that sponsors must have at least two Principals at all times. To qualify as a Principal, an individual must:
- (a) be a responsible officer (in the case of a sponsor that is a licensed corporation) or an executive officer (in the case of a sponsor that is a registered institution);
 - (b) demonstrate that he has acquired a minimum of five years of relevant corporate finance experience in respect of companies listed on the Main Board or the GEM Board of the Stock Exchange; and
 - (c) demonstrate that in the five years immediately preceding his appointment as a Principal, he has played a "substantial role" in advising listing applicants, in the capacity of a sponsor, in at least two completed IPO transactions on the Main Board or the GEM Board of the Stock Exchange.
101. From the SFC's perspective, administering the "substantial role" requirement can be problematic in situations where a number of individuals claim to have played a "substantial role" in the same IPO transaction. These claims can be exaggerated and the process of determining the true extent of a particular applicant's involvement in an IPO transaction can be lengthy and time-consuming.
102. The SFC is aware, however, of the challenge that sponsors can face in securing the services of individuals who qualify as Principals. This difficulty often arises in the case of individuals who have not previously worked in Hong Kong, or who do not have recent working experience in Hong Kong, but who are highly experienced in other comparable jurisdictions. The SFC would like to address both of these issues and aims to expand the eligibility criteria for Principals in a way that does not have any adverse impact on standards but enlarges the category of individuals eligible to qualify as Principals.
103. Feedback received by the SFC from the market in this connection has included proposals:
- (a) that the eligibility criteria for Principals be expanded by the SFC recognising relevant experience acquired overseas in comparable jurisdictions;



- (b) that there be greater emphasis on experience in the area of due diligence, either in Hong Kong or elsewhere; and
- (c) that new examinations be introduced for Principals which test an applicant's knowledge of sponsor work and the regulatory regime which governs the conduct of sponsors in Hong Kong.

It has also been proposed that new examination requirements be imposed on individuals seeking to be licensed as Type 6 representatives accredited to sponsors.

104. The SFC invites comments on the current eligibility criteria for Principals and the means by which these criteria might be amended.

**Q25. Which, if any, of the proposals in paragraph 103 would achieve the objectives of enlarging the category of individuals qualified to act as Principals whilst not affecting the overall quality of sponsor work?
Do you have alternative suggestions to address the issues?**

Multiple sponsors

105. The appointment of multiple sponsors for IPO transactions is common and there are concerns that this has affected the standard of sponsors' work. The more widely duties and functions are spread among multiple sponsors, the greater is the risk of fragmentation of work, gaps and overlaps.
106. From the perspective of investors, we question whether there are any benefits in appointing more than one sponsor. We understand that in many cases a "lead" sponsor takes on the main role in dealing with the regulators, co-ordinating the IPO process and in conducting detailed due diligence. Nevertheless, where there is more than one sponsor, an inevitable risk is duplication of work and an increased chance that key issues are missed. Whilst appointing more than one sponsor might enable issues to be considered from more than one perspective, this benefit may be outweighed by the dispersal of effective responsibility and oversight. There is anecdotal evidence that the presence of multiple sponsors can also lead to discord between those involved, including the listing applicant, which may have an adverse impact on the listing process. Accordingly, we believe that the appointment of only one sponsor on each listing should provide greater assurance to the market as to the quality of listing documents.

**Q26. Do you agree that there should only be one sponsor on each engagement?
If you do not agree, should the number of sponsors be limited and, if so, to how many?
If you do not agree that the numbers of sponsors should be limited, why not?**

107. In some cases more than one sponsor is appointed to comply with the Listing Rules³³ requirement for at least one sponsor to be independent of the applicant. In 2004, a joint SFC and Stock Exchange consultation conclusions paper stated that an entity that does

³³ See rule 3A.07 of the Listing Rules.



not meet the independence requirements should nevertheless be allowed to act as a sponsor provided that another independent sponsor is also appointed. It was considered that this would minimise the risk of advice being incomplete or lacking in objectivity. Accordingly the original proposal only to allow sponsors to be appointed which are independent of the listing applicant was not pursued.

108. In view of the vital role of sponsors in all IPOs we believe it would be appropriate to revisit that decision. There have been comments that, in some cases where an independent sponsor has been appointed in order to meet the independence requirements, in practice another non-independent sponsor still leads all substantive sponsor work. This raises considerable doubt as to the efficacy of the current rules in protecting investors. If it is decided not to proceed with a proposal to have only one independent sponsor we consider that only entities that meet the independence requirements should be allowed to act as sponsor.

**Q27. If more than one sponsor is allowed, do you agree that they should all be required to meet the Listing Rules independence requirements?
If not why not?**

109. If more than one sponsor were to be appointed, this does not reduce or limit any of their responsibilities. The Listing Rules specify that where a listing applicant has more than one sponsor, each of the sponsors has responsibility for ensuring that the obligations and responsibilities under the Listing Rules are fully discharged³⁴. If it is decided not to proceed with our proposal to have only one sponsor we would also clarify in the Code of Conduct that where a listing applicant appoints more than one sponsor:

- (a) the appointment does not relieve any of the sponsors of any of their responsibilities under the Code of Conduct; and
- (b) all sponsors are jointly and severally responsible for complying with the requirements under the Code of Conduct in relation to the listing application.

We appreciate, however, that joint and several responsibility can imply that each sponsor should have access to and actively review each other's work to assure themselves of the overall quality of work done. This may be difficult to accomplish in practice and also could be resource-intensive and duplicative even if there were a sufficient degree of co-operation amongst all involved. This would suggest that it may be more effective and efficient to appoint only one sponsor.

**Q28. Do you agree that if more than one sponsor is appointed each sponsor's responsibilities should remain unaffected and that each sponsor should comply with all the expectations of a sponsor?
If not, why not?**

110. We recognise that listing applicants may wish to market their shares to a wide spectrum of investors, and to do this seek to have many financial institutions involved in marketing the IPO. In proposing to only allow one sponsor we are not seeking to prescribe any limitations as to the number or identity of the institutions taking on other roles in an IPO,

³⁴ See rule 3A.10 (3) of the Listing Rules.



such as global co-ordinators, book-runners, managers, other underwriters and financial advisers.

111. Subject to the final outcome of this consultation we will work with the Stock Exchange to amend the Listing Rules to implement the proposals concerning the appointment of sponsors.

Overall manager of a public offer (paragraph 17.10)

112. The CFA Code sets out the duties of a sponsor to act as the overall manager of the public offer process and ensure sufficient arrangements are in place so that the public offer is conducted in a fair and orderly manner³⁵. **We propose transferring these specific duties and obligations to the Code of Conduct. The transferred provisions will be deleted from the CFA Code (Proposal 20).**

Q29. Do you agree that the provisions of the CFA Code relating to the management of a public offer should be transferred to the Code of Conduct?
If not, why not?

Information provided to analysts in new listings (paragraph 17.11)

113. The CFA Code requires a sponsor to take reasonable steps to ensure that all material information, including forward-looking information (whether quantitative or qualitative) disclosed or provided to analysts is contained in the relevant listing document³⁶. **We propose transferring this obligation to the Code of Conduct. The transferred provision will be deleted from the CFA Code (Proposal 21).**

Q30. Do you agree that the obligation in the CFA Code relating to the provision of information to analysts should be transferred to the Code of Conduct?
If not, why not?

Scope of Provisions

114. The Provisions set out the SFC's expectations of Sponsors, who are appointed pursuant to a requirement of the Listing Rules³⁷. In the case of a listing of a Real Estate Investment Trust (**REIT**), the REIT appoints a listing agent which acts as sponsor³⁸. Accordingly, we propose that a listing agent is required to comply with the Provisions in performing its functions.

³⁵ See paragraphs 5.3 and 5.4 of the CFA Code.

³⁶ See paragraph 5.10 of the CFA Code.

³⁷ See rule 3A.02 of the Listing Rules.

³⁸ See 5.11(c) of the Code on Real Estate Investment Trusts.



**Q31. Do you agree that the Provisions should equally apply to a listing agent appointed for the listing of a REIT?
If not, why not?**

Others

115. For ease of reference, we set out in **Appendix B** a summary of the proposed Provisions, together with the text of related existing requirements and source rules, if applicable.



Prospectus liability

Background

116. The prospectus liability of sponsors was discussed in an SFC consultation and subsequent consultation conclusions in 2005 and 2006. It was considered premature to proceed at that time as the new non-statutory sponsor regime had yet to be fully implemented³⁹.
117. It is axiomatic that accurate and complete disclosure in a prospectus is fundamental for investor protection. Defective disclosure may lead to investor losses.
118. Statutory liability underpins prospectus accuracy. The Companies Ordinance contains separate provisions dealing with civil liability and criminal liability for any untrue statement, including a material omission, in a prospectus.⁴⁰
119. Section 40 of the Companies Ordinance specifies those persons who are liable to pay compensation to those who subscribe for shares or debentures on the faith of a prospectus for the loss or damage they sustain by reason of any untrue statement. Four categories are specified: every director of the company at the time of the issue of the prospectus; every person who has authorized himself to be named in the prospectus as a director of the company or as having agreed to become one; every promoter of the company and every person who has authorized the issue of the prospectus. The last category includes experts such as valuers and accountants to the extent of any untrue statement in their expert report that is included in the prospectus with their written consent. Certain defences are provided including where the person proves that he had reasonable grounds to believe and did believe up to the time of allotment of the shares or debentures that the statement was true.⁴¹
120. Section 40A(1) of the Companies Ordinance provides that, where any untrue statement is included in a prospectus, any person who authorized the issue of the prospectus is liable to imprisonment and a fine unless he proves either that the statement was immaterial or that he had reasonable grounds to believe and did believe up to the time of issue of the prospectus that the statement was true. A person is liable to a fine of up to \$700,000 and a term of imprisonment of up to three years for conviction on indictment or a fine of up to \$150,000 and imprisonment of up to 12 months upon summary conviction.
121. It has been argued that sponsors may already be subject to civil and criminal liability under the Companies Ordinance for untrue statements in prospectuses. This is because:
- (a) sponsors might fall under the definition of “promoters”, who are subject to civil liability.⁴² A promoter is defined as a party who is involved in the preparation of the prospectus but not including any person by reason of his acting in a

³⁹ See page 3 of the SFC’s Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance issued in September 2006.

⁴⁰ Under section 41A(2) of the Companies Ordinance, an “untrue statement” in relation to a prospectus includes a material omission from the prospectus.

⁴¹ Section 40(2)(d)(i) in relation to persons other than experts; section 40(3)(c) in relation to experts.

⁴² Section 40(1)(c) of the Companies Ordinance.



professional capacity for persons engaged in procuring the formation of the company.⁴³

- (b) some market participants take the view that a sponsor is a person “who has authorized the issue of the prospectus”. As noted above, a person who authorizes the issue of a prospectus is subject to civil and criminal liability under the Companies Ordinance for untrue statements in a prospectus.

122. There is however no Hong Kong case law on whether sponsors are subject to these provisions. As the position is unclear the SFC believes there is merit in removing this ambiguity by clearly identifying sponsors as also being liable for untrue statements in prospectuses.

Clarification that prospectus liability extends to sponsors

Should sponsors be liable for untrue statements in a prospectus?

123. Sponsors have clear responsibilities under existing non-statutory rules and codes for the contents of a prospectus, and the proposals in the first part of this consultation paper are designed to clarify and reinforce these. The non-statutory provisions place an emphasis on the sponsor’s role as a gatekeeper and on conducting due diligence. These conduct rules are relevant to a sponsor’s performance of the regulated activity for which it is licensed or registered by the SFC under the SFO, regardless of whether the final listing document contains any untrue statements. The question is whether it should be made clear that sponsors are also subject to potential legal liability for untrue statements in a prospectus along with others who authorize the issue of a prospectus or who are otherwise responsible for its contents.
124. Market participants have expressed concerns that if sponsors were to have such liability this would unduly shift the focus of responsibility to them and away from the issuer, its directors and experts where it belongs. The SFC does not believe that this concern is sustainable; clarified prospectus liability for sponsors, who are already required to play a central role in ensuring that prospectus disclosure is accurate and complete, would not derogate from existing statutory responsibilities of directors and other participants in an IPO.
125. Some commentators have taken the view that explicit statutory sponsor liability for untrue statements in a prospectus would not deter defective prospectus disclosure, particularly where information has been deliberately concealed from the sponsor by the listing applicant. Other commentators question whether prospectus liability would realistically encourage better quality disclosure; they are concerned that prospectus liability may have the effect of encouraging more disclosure than is necessary. In contrast, many believe that prospectus liability may encourage sponsors to undertake more rigorous due diligence and this may in some cases help to detect concealed information as well as providing greater assurance overall. We should make clear here that we do not expect sponsors to be able to detect all attempts to conceal information or otherwise to mislead, whether on the part of the management of a listing applicant or others. The requirement to carry out reasonable due diligence cannot be expected to amount to a guarantee of an absence of fraud, forgery or deliberate non-disclosure. But we consider that a responsible and proactive due diligence exercise in line with the standards set out in the first part of this consultation paper should in practice serve to

⁴³ Section 40(5)(a) of the Companies Ordinance.



expose some instances of misconduct. Taking all of these views into account, and after a careful review of the Hong Kong IPO market, together with informal discussions with market participants, we have concluded that making it clear that a sponsor also has liability for untrue statements in a prospectus is likely to further encourage sponsors to prepare and review disclosures in a prospectus critically so as to provide a high level of assurance that the information disclosed is accurate, relevant, concise and meaningful for investors. Certainty as to the meaning and scope of any liability regime is essential and is in the public interest.

126. This would make it clear that public investors would be able to take legal action against sponsors (among others) in connection with untrue statements in a prospectus. It would also enable prosecutions of sponsors to take place in serious cases. In addition, since the prospectus liability provisions are also “relevant provisions” as defined in the SFO, the SFC would also be in an unambiguous position to take action such as conducting investigations and making applications to the Court of First Instance for remedial orders.

**Q32. Do you agree that it should be made clear that sponsors are liable for untrue statements (including material omissions) in a prospectus?
If not, why not?**

How to define sponsor?

127. For the purpose of the liability provisions we propose to define “sponsor” to mean any licensed corporation or registered institution that is licensed or registered under the SFO for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a sponsor and that is appointed as a sponsor under the Listing Rules.

**Q33. Do you have any views on the proposed definition of “sponsor”?
Please explain your views.**

International practice

128. International practice varies on the issue of whether sponsors have statutory liability for untrue statements in a prospectus. The concept of holding sponsors (and other specified persons) liable is largely in line with the philosophy in many major markets that a person who is involved in formulating the disclosures in a prospectus is to be held liable for errors or omissions. However, there is considerable variation across jurisdictions and laws have been developed over time that are tailored to the particular structure of each market: in some markets sponsors are not required⁴⁴ and in other markets there may be persons playing a similar role but who are not called sponsors⁴⁵. Therefore, Hong Kong needs to develop its own approach in light of the particular characteristics of its IPO market.

⁴⁴ E.g. US and Australia.

⁴⁵ E.g. in Singapore issue managers play a similar role to sponsors in a Hong Kong IPO.



Other issues

129. In addition to clarifying the issue of sponsor liability for untrue statements in a prospectus, there are other questions concerning prospectus liability which merit review. These include:

- whether the scope of the criminal and civil liability provisions should be aligned so that the same categories of persons are covered by both;
- whether the tests for establishing civil and criminal liability, including the existing defences referred to in paragraphs 119 and 120 should be modified; and
- the relevance of actual reliance on a prospectus as a prerequisite for private rights of actions and the ability of investors transacting in the secondary market to make claims based on defective prospectus disclosure.

The SFC intends to address these and other issues as part of its overall review of the prospectus regime in a separate consultation paper.



Seeking Comments

130. The SFC welcomes comments from the public on the proposals made in this consultation paper and the indicative draft of the proposed amendments to the Code of Conduct in **Appendix A** to this consultation paper. Comments should be submitted to the SFC in writing by no later than 6 July 2012.



Appendix A – Indicative draft of a new paragraph 17 of Code of Conduct

17.1 Introduction

- (a) This paragraph applies to a licensed corporation or registered institution, licensed or registered under the SFO for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a sponsor and which is appointed as a sponsor by an applicant seeking a listing of its securities on the Stock Exchange under the Listing Rules¹.
- (b) A sponsor's primary role is to provide assurance to the Stock Exchange and the market generally that the listing applicant complies with the Listing Rules and other applicable legal and regulatory requirements and that the listing document provides sufficient particulars and information for investors to form a valid and justifiable opinion of the listing applicant's shares², financial condition and profitability. A sponsor also advises and guides the listing applicant as to the Listing Rules and other applicable regulatory requirements.
- (c) The Commission attaches a great deal of importance to maintaining the integrity of the market and the transparency in fund raising and other listing exercises. This paragraph sets out the responsibilities and obligations which a sponsor should fulfil when discharging its functions as a sponsor. This paragraph also contains standards and provides guidance on due diligence procedures in respect of a listing application. In assessing whether a sponsor is fit and proper to remain licensed or registered and permitted to carry out its sponsor work, the Commission will have regard to the provisions of this paragraph.

17.2 Key requirements

A sponsor should comply with the following key requirements in order to discharge its role satisfactorily.

- (a) Advising a listing applicant
A sponsor should advise and guide a listing applicant in preparation for a listing.
- (b) Due diligence required before submitting a listing application
Before submitting a listing application a sponsor should complete all reasonable due diligence on a listing applicant save only any matters that by their nature can only be dealt with at a later date.
- (c) Disclosure to the market

¹ Under Listing Rule 3A.02, an applicant seeking a listing of its securities on the Stock Exchange must appoint a sponsor to assist it with its application for listing. References to the Main Board Listing Rules in this paragraph should be taken to cover the equivalent GEM Listing Rules.

² In some cases a listing will involve other securities such as debentures or equity interests other than shares, for example units in a REIT. Where a listing agent is appointed for a listing of units in a REIT, the provisions under this paragraph will equally apply to the listing agent.



A sponsor should ensure that true, accurate and complete disclosure about a listing applicant be made to the public.

(d) Due diligence

A sponsor should take reasonable due diligence steps in respect of a listing application.

(e) Communication with the regulators

A sponsor should deal with the regulators in a truthful, cooperative and prompt manner.

(f) Proper records

A sponsor should maintain proper books and records that are sufficient to demonstrate its compliance with all applicable legal and regulatory requirements.

(g) Resources, systems and procedures

A sponsor should maintain sufficient resources and effective systems and procedures for proper implementation and adequate management oversight of due diligence work.

(h) Overall manager of a public offer

A sponsor should act as the overall manager of a public offer to ensure that the public offer is conducted in a fair and orderly manner.

(i) Information provided to analysts in new listings

A sponsor should ensure analysts do not receive material information not disclosed in the listing document.

17.3 Advising a listing applicant

(a) Understanding a listing applicant

A sponsor should have a sound understanding of a listing applicant, including its history and background, business and performance, financial condition and prospects, operations and structure, procedures and systems, as well as the directors, key senior managers and (where applicable) controlling shareholders of the listing applicant.

[CFA Code 6.1³]

(b) Advice and guidance

(i) A sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements and take all reasonable steps to ensure that at

³ Denote the source of the relevant proposed provision where applicable.



all stages of the listing application process they understand and meet these responsibilities.

- (ii) A sponsor should provide appropriate advice and recommendations to a listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers and ensure that any material deficiencies are remedied prior to the submission of a listing application.

[CFA Code 6.3]

17.4 Work required before submitting a listing application

- (a) Completion of reasonable due diligence

Before submitting an application on behalf of a listing applicant to the Stock Exchange a sponsor should complete all reasonable due diligence on the listing applicant save only any matters that by their nature can only be dealt with at a later date.

[New]

- (b) Completeness of information in an Application Proof

Before submitting an application on behalf of a listing applicant to the Stock Exchange a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete.

[LR 9.03(3)]

- (c) Resolving fundamental compliance issues

Before submitting an application on behalf of a listing applicant to the Stock Exchange a sponsor should come to a reasonable opinion that:

- (i) the listing applicant is in compliance with all the applicable listing conditions under the Listing Rules (except to the extent that waivers from compliance with those requirements have been applied for to the Stock Exchange in writing);
- (ii) the listing applicant has established procedures, systems and controls (including accounting and management systems) which enable the listing applicant and its directors to comply with the Listing Rules and other applicable legal and regulatory requirements on an ongoing basis;
- (iii) the listing applicant has established procedures, systems and controls (including accounting and management systems) which provide a reasonable basis for the directors to make a proper assessment of the financial position and prospects of the listing applicant on an ongoing basis; and
- (iv) the directors of the listing applicant collectively have the experience, qualifications and competence to manage the listing applicant's business and comply with the Listing Rules and other applicable legal and regulatory requirements, and individually have the experience,



qualifications and competence to perform their individual roles, including an understanding of their obligations and those of the listing applicant as an issuer under the Listing Rules and other applicable legal and regulatory requirements relevant to their role.

[LR 3A.15(2), (5) and (6)]

(d) Identifying material issues

When submitting an application on behalf of a listing applicant to the Stock Exchange, a sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of:

- (i) whether the listing applicant is suitable for listing; and
- (ii) whether the listing of the applicant's securities is contrary to the interest of the investing public or to the public interest;

are disclosed with sufficient prominence in the Application Proof or otherwise in writing to the Stock Exchange.

[FSA Listing Rule 8.4.3(3)]

17.5 Disclosure to the market

(a) Overall disclosure

At the time of issue of a listing document, a sponsor, after reasonable due diligence, should ensure that the listing document contains sufficient particulars and information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the shares and the financial condition and profitability of the listing applicant.

[LR 3A.15(3)]

(b) Disclosure: non-expert sections

At the time of issue of a listing document, a sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that:

- (i) the information in the non-expert sections of the listing document is true, accurate and complete in all material respects and not misleading or deceptive; and
- (ii) there are no matters or facts the omission of which would make any information in the non-expert sections of a listing document or any part of the listing document misleading.

[LR 3A.15(4)]

(c) Disclosure: expert sections

At the time of issue of a listing document, a sponsor should be in a position to demonstrate that it is reasonable for it to rely on the expert sections of the listing document.

[Australian Corporations Act, ss 733(1)]



17.6 Due diligence

(a) Reasonable judgement

A sponsor should conduct reasonable due diligence in order to have a proper and thorough knowledge and understanding of a listing applicant and to satisfy itself in relation to the disclosure in the listing document. A sponsor should exercise reasonable judgement on the nature and extent of due diligence work needed in relation to a listing applicant having regard to all relevant facts and circumstances. A sponsor should recognise that the nature and extent of due diligence varies from case to case depending on the facts and circumstances and there is no exhaustive list of due diligence steps that would apply in all circumstances.

[PN 21(2)]

(b) Professional scepticism

In undertaking its role a sponsor should examine with professional scepticism the accuracy and completeness of statements and representations made, or other information given, to it by a listing applicant or its directors. An attitude of professional scepticism means making a critical assessment with a questioning mind and being alert to information, including information from experts, that contradicts or brings into question the reliability of such statements, representations and information.

[PN 21(2)]

(c) Appropriate verification

A sponsor should not merely accept statements and representations made and documents produced by a listing applicant or its directors at face value. Depending on the nature and source of the information and the context in which the information is given, the sponsor should perform verification procedures that are appropriate in the circumstances, such as reviewing source documents, inquiring of knowledgeable persons or obtaining independently sourced information. Where the sponsor becomes aware of circumstances that may cast doubt on information provided to it or otherwise indicate a potential problem or risk, the sponsor should undertake additional due diligence to ascertain the truth and completeness of the matter concerned.

[PN 21(2)]

(d) Preparation of a listing document

Regarding the preparation of a listing document, a sponsor should perform, without limitation, each of the following:

- (i) oversee, and be closely involved in, the preparation of the listing document;
- (ii) achieve a proper and thorough understanding of the listing applicant, including its business, history, background, structure and systems;



- (iii) gain a sufficient understanding of the industry in which the listing applicant operates, including reviewing the industry landscape and comparable data about competitors;
- (iv) examine and consider the integrity, qualifications and competence of the directors, including reviewing internal records, board minutes and public filings;
- (v) examine and consider the accuracy and reliability of the financial information, including reviewing the financial statements of major subsidiaries, internal financial records, tax certificates, regulatory filings and public records;
- (vi) assess the business performance, financial condition, development, prospects and any financial projection or profit forecast;
- (vii) assess the legality and state of compliance of the business operations and whether the listing applicant is subject to any material legal proceedings or disputes;
- (viii) assess whether there has been any material change since the date of the last audited balance sheet, including any matter that might impact upon the listing applicant's business model, performance, prospects or financial condition; and
- (ix) undertake independent verification of all material information, including documents provided, and statements and representations made, by the listing applicant.

[PN 21]

(e) Independent due diligence steps

A sponsor should conduct the following independent due diligence steps:

- (i) review material underlying records and supporting documents of the listing applicant such as tax certificates, bank statements, contracts etc;
- (ii) inquire of knowledgeable persons within or outside the listing applicant e.g. directors, key management staff, consultants and controlling shareholder(s);
- (iii) conduct site visits of production facilities and other key physical assets;
- (iv) obtain written confirmations from third parties;
- (v) interview major business stakeholders such as the listing applicant's customers, suppliers, creditors and bankers; and
- (vi) where material, independently obtain information from sources outside the listing applicant, including searches of public filings and databases, external confirmations, third-party data about competitors and the engagement of external agents to perform relevant checks.



[New]

(f) Interview practices

Where a sponsor interviews major business stakeholders (e.g. customers, suppliers, creditors and bankers), the sponsor should adopt effective and adequate measures to ensure that the results of the interviews are accurate, complete and reliable. In conducting interviews, the sponsor should:

- (i) select independently those to be interviewed based on objective and proportionate criteria, e.g. those with whom the listing applicant has entered into high value transactions or entities with special or unusual characteristics;
- (ii) carry out the interview directly with the person or entity selected with minimal involvement of the listing applicant;
- (iii) ascertain the identity of the interviewee to ensure that the interviewee has the appropriate authority and knowledge for the interview;
- (iv) hold an in-depth discussion to obtain adequate and satisfactory responses to all questions raised and follow up on any incomplete responses or outstanding matters; and
- (v) identify any irregularities noted during the interview (e.g. reluctance on the part of the interviewee to cooperate) and ensure any irregularities are adequately explained and resolved.

[New]

(g) Reliance on an expert report

In order for a sponsor to demonstrate that it is reasonable for it to rely on an expert report of a listing document, the sponsor should perform, without limitation, each of the following:

- (i) confirming that the expert is appropriately qualified and experienced, the bases and assumptions adopted by the expert are fair and reasonable, the expert's scope of work is appropriate to the opinion and the expert is independent from the listing applicant;
- (ii) as regards financial information, work with the reporting accountants to understand the critical accounting policies and estimates, review relevant accounting systems and controls, assess the financial information against business performance and other operating aspects and assess the veracity of any management discussion and analysis of financial performance and condition;
- (iii) as regards valuation, work with the valuer to understand the bases, assumptions and methodology, assess the valuation against business performance and other operating aspects and compare the valuation with independent publicly available valuations of corporate assets;



- (iv) ensure that factual information on which an expert relies in preparing its report is consistent with the sponsor's knowledge including that derived from its other due diligence work;
- (v) where factual information on which an expert relies is solely or primarily derived from management's representations and confirmations, unless the expert has done so, make independent inquiries or assessments or obtain independently sourced information to verify the accuracy and completeness of the information;
- (vi) corroborate information obtained from different sources to ensure the consistency of information disclosed in the expert report with information disclosed in the non-expert sections and any information known to the sponsor including that derived from its other due diligence work; and
- (vii) where discrepancies or irregularities or suspicious circumstances are identified, thoroughly follow up to ensure they are resolved.

[LR 3A.16]

(h) Seeking assistance from third parties

A sponsor cannot delegate responsibility for due diligence. Where a sponsor engages a third party to assist it to undertake specific due diligence tasks (e.g. engaging lawyers to undertake verification of title to properties, accountants to review internal controls, consultancy firms to undertake market research, agencies to perform investigative work, etc), the sponsor is responsible for ensuring reasonable due diligence in respect of the matters to which the specific tasks relate. The third party's work, in itself, would not be sufficient evidence that a sponsor has discharged its obligation to conduct reasonable due diligence. As a minimum the sponsor should:

- (i) assess whether the third party is appropriately qualified and competent for the tasks assigned to it;
- (ii) determine the scope and extent of tasks to be performed by the third party;
- (iii) assess the results of the work performed by the third party and arrive at its own opinion whether the work provides a sufficient basis to determine that reasonable due diligence has been conducted and whether further due diligence is required; and
- (iv) assess whether the results of the work should be incorporated in the listing document or brought to the attention of regulators.

[PN 21(5)]

(i) Stock Exchange Listing Rules

The Stock Exchange sets out its expectations of due diligence sponsors would typically perform in PN21. PN21 explains that it is not in any way intended to set out the actual steps that may be appropriate in any particular case. Each listing applicant is unique and so will be the due diligence appropriate for the



purpose of its listing application. The scope and extent of appropriate due diligence by a sponsor may be different from (and considerably more extensive than) the more typical examples in PN21. The sponsor should exercise its judgement as to what investigations are appropriate for a particular case and the extent of due diligence. Sponsors are reminded of their obligations to comply with the Listing Rules and the relevant practice notes and guidelines on due diligence standards.

[PN 21(3)]

17.7 Communications with the regulators

- (a) A sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and the SFC during the listing application process is accurate, complete and not misleading and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the Stock Exchange and the SFC (as the case may be) promptly.

[LR 3A.04, CFA code 6.3]

- (b) A sponsor should deal with all enquiries raised by, and provide all relevant information and documents requested by the Stock Exchange and the SFC (as the case may be) promptly, including answering any questions addressed to the sponsor in a cooperative and truthful manner.

[LR 3A.04, CFA code 6.3]

- (c) Where a sponsor becomes aware of any material information relating to a listing applicant or listing application which concerns non-compliance with the Listing Rules or other applicable legal or regulatory requirements (except as otherwise disclosed pursuant to paragraph 17.4(d)), it should report the matter to the Stock Exchange in a timely manner.

[FSA Listing Rule 8.3.5A]

- (d) Where a sponsor ceases to act for a listing applicant during the listing application process, the sponsor should inform the Stock Exchange in a timely manner of the reasons for ceasing to act.

[New]

17.8 Proper records

- (a) A sponsor should maintain adequate records so as to demonstrate to the SFC its compliance with all applicable legal and regulatory requirements and in particular compliance with this paragraph. In particular a sponsor should document, in respect of each listing transaction:

- (i) due diligence
- (A) a due diligence plan identifying the required time and skill sets of persons needed to implement the plan;
 - (B) changes to the due diligence plan and reasons therefor;
 - (C) the nature, timing and extent of due diligence procedures; and
 - (D) the results of due diligence performed together with its



assessment of these results;

- (ii) for due diligence procedures conducted by third parties, information relating to the matters in paragraph 17.6(h);
 - (iii) the bases for the opinions, assurances and conclusions required under paragraphs 17.3, 17.4 and 17.5, including internal discussions and any action taken prior to these opinions and assurances being given or conclusions being reached;
 - (iv) all significant matters arising in the course of the listing application process, including internal discussions and actions taken, regardless of whether or not the relevant matters are disclosed in the final listing document;
 - (v) the involvement of Management in supervising key issues as referred to in paragraph 17.9(e); and
 - (vi) supporting documents and correspondences concerning the matters set out in (i) to (v) above.
- (b) A complete set of a sponsor's records in connection with a listing transaction should be retained in Hong Kong for at least seven years after completion or termination of the transaction.

[New]

17.9 Resources, systems and procedures

A sponsor should maintain sufficient resources and effective systems and procedures to ensure that the sponsor is able to meet and does meet all its obligations under this paragraph. In particular:

- (a) before accepting any appointment as a sponsor of an assignment, taking account of other commitments, the sponsor should ensure that it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment throughout the period of the assignment;
- (b) taking account of the volume, size, complexity and nature of sponsor work required to be undertaken in respect of each assignment and any other factors that may affect the standard of sponsor work, the sponsor should appoint a Transaction Team which:
 - (i) comprises staff with appropriate levels of knowledge, skills and experience; and
 - (ii) includes at least one Principal who acts as the supervisor of the Transaction Teamto carry out the assignment throughout the period of the assignment.
- (c) an appropriate due diligence plan should be formulated, updated as necessary and implemented in respect of each assignment and any outstanding steps or steps which deviate from the original plan should be identified and followed up;



- (d) there must be clear and effective reporting lines and channels so that key issues are escalated to Management for deliberation;
- (e) Management should assume full responsibility for the sponsor's operations and supervise key issues, including but not limited to:
 - (i) accepting a mandate to act as a sponsor;
 - (ii) monitoring the implementation of the due diligence plan;
 - (iii) ensuring that sufficient persons with appropriate levels of knowledge, skills and experience are devoted to each assignment over the period of the assignment;
 - (iv) reviewing the standard and extent of due diligence work, and the performance of the Principals and the Transaction Team; and
 - (v) resolving suspicious circumstances, difficult or sensitive issues, conflicting information and material non-compliance.
- (f) Management is ultimately responsible for the supervision of the sponsor work undertaken by the firm, as well as compliance with all applicable legal and regulatory requirements. While Management may delegate the operational functions to the staff of a sponsor, Management remains responsible for the discharge of these functions and its responsibilities cannot be delegated.

[Part 1 of Internal Control Guidelines, Paragraphs 1.1.3, 1.1.5, 1.1.6, 1.2.4 and 1.2.5 of the Sponsor Guidelines]

17.10 Overall manager of a public offer

- (a) Overall management

Where a listing application involves a public offer, a sponsor should act as the overall manager of the public offer. In doing so, the sponsor should:

- (i) assess the likely interest in, or the reception of, the offer by the public; and
- (ii) put in place sufficient arrangements and resources to ensure that the public offer and all matters ancillary thereto are conducted in a fair, timely and orderly manner.

[CFA code 5.3]

- (b) Sufficient arrangements and resources

In discharging its obligations under (a) above, the sponsor should have regard to at least the following matters:

- (i) whether there are sufficient arrangements to ensure that listing documents (in both electronic and printed form) and application forms (in printed form) are made readily available to the public during the public offer period;



- (ii) without derogating from the sponsor's obligation to act as the overall manager of the public offer, whether specific responsibilities in relation to the public offer should be delegated to other parties; and if so, whether these parties are competent and have sufficient capacity and resources to handle the relevant responsibilities;
- (iii) whether sufficient measures have been put in place to ensure that (A) the distribution of prospectuses and application forms to the public; (B) the collection of completed application forms from the public; and (C) the despatch of unsuccessful applications, refund cheques and share certificates after the public offer period closes, can be made in a timely and orderly fashion;
- (iv) the need to avoid events of disorder or failure which may arise during the public offer period and before the trading of securities commences or otherwise in connection with the public offer, and ensure that appropriate contingency plans have been drawn up to deal with any such events; and
- (v) where balloting is required to determine the successful applications under a public offer, whether appropriate arrangements have been put in place to ensure that balloting would be conducted fairly and independently of the listing applicant and parties associated with it.

[CFA code 5.4]

17.11 Information provided to analysts in new listings

A sponsor should take reasonable steps to ensure that all material information, including forward-looking information (whether quantitative or qualitative) concerning a listing applicant or listing application disclosed or provided to analysts is contained in the relevant listing document.

[CFA code 5.10]

17.12 Glossary

For the purpose of this paragraph,

- (a) "Application Proof" means an advanced proof of the listing document submitted with the listing application under the Listing Rules
- (b) "expert" includes every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him
- (c) "expert section" means , in relation to a listing document, any part of the listing document purporting to be made on the authority of an expert or purporting to be a copy of or extract from a report, opinion, statement or valuation of an expert where the expert gives consent for the inclusion in the listing document of the copy or extract and the listing document includes a statement that he has given and has not withdrawn such consent
- (d) "listing applicant" means an applicant seeking a listing of securities on the Stock Exchange



- (e) “listing application” means an application for the listing of any securities issued or to be issued by an applicant and all documents in support of or in connection with the application, including any replacement of, and amendment and supplement to, the application
- (f) “listing document” means a prospectus, a circular and any equivalent document (including a scheme of arrangement and introduction document) issued or proposed to be issued in connection with an application for listing
- (g) “Listing Rules” means the Rules Governing the Listing of Securities on the Stock Exchange
- (h) “Management” includes a sponsor firm’s Board of Directors, Managing Director, Chief Executive Officer, Responsible Officers, Executive Officers and other senior management personnel
- (i) “non-expert sections” means, in relation to a listing document, any part of the listing document that is not part of an expert section
- (j) “PN21” means Practice Note 21 of the Listing Rules
- (k) “Principal” means a Responsible Officer or an Executive Officer that is appointed by a sponsor firm to be in charge of the supervision of the Transaction Team for a listing assignment
- (l) “public offer” means, in relation to a listing application, an offer for subscription or an offer for sale of securities to the public
- (m) “REIT” means Real Estate Investment Trust
- (n) “Stock Exchange” means The Stock Exchange of Hong Kong Limited
- (o) “Transaction Team” means the staff appointed by a sponsor firm to carry out a listing assignment



Appendix B – Summary of proposed Provisions and applicable sources

	Proposed Provision	Existing requirement (source rule)
1.	A sponsor should have a sound understanding of a listing applicant, including its history and background, business and performance, financial condition and prospects, operations and structure, procedures and systems, as well as the directors, key senior managers and (where applicable) controlling shareholders of the listing applicant. (Paragraph 17.3(a))	Unless the circumstances do not require, a CFA should understand the business of its client. In particular, a CFA should (a) obtain at the outset, information regarding its client's background, the nature of its business, and if the client is a company, the identity of its controlling shareholders(s), and its shareholding structure; and (b) understand the financial circumstances and investment or corporate objectives in relation to the transaction under consideration. (CFA Code 6.1)
2.	A sponsor should advise and guide a listing applicant and its directors as to their responsibilities under the Listing Rules and other applicable regulatory requirements and take all reasonable steps to ensure that at all stages of the listing application process they understand and meet these responsibilities. A sponsor should provide appropriate advice and recommendations to the listing applicant on any material deficiencies identified in relation to its operations and structure, procedures and systems, or its directors and key senior managers and ensure that any material deficiencies are remedied prior to the submission of a listing application. (Paragraph 17.3(b))	A CFA should use all reasonable efforts to ensure that its client understands the relevant regulatory requirements and their implications at all stages of a transaction. (CFA Code 6.3)
3.	Before submitting a listing application, a sponsor should complete all reasonable due diligence on the listing applicant save only any matters that by their nature can only be dealt with at a later date. (Paragraph 17.4(a))	–
4.	Before submitting a listing application, a sponsor should come to a reasonable opinion that the information in the Application Proof is substantially complete. (Paragraph 17.4(b))	The Stock Exchange expects to receive an advanced proof of the prospectus with the listing application form that is not the initial proof so that the Stock Exchange's review can commence immediately. The Stock Exchange expects that requisite information in accordance with the relevant listing rules can only be substantially completed in the advanced proof. If the Stock Exchange considers the draft prospectus as submitted not to be in an advanced form, it will not commence the review and will return all application documents, including the draft prospectus, to the sponsor. (LR 9.03(3))
5.	Before submitting a listing application, a sponsor should come to a reasonable opinion that: a) the applicant has complied with all applicable listing conditions (except to the extent that waivers from compliance have been applied for);	A sponsor must confirm to the Stock Exchange on or before the date of issue of the listing document that a) the listing applicant fulfils all listing conditions (except to the extent that compliance with those rules has been



	Proposed Provision	Existing requirement (source rule)
	<p>b) the applicant has established adequate systems and procedures to ensure compliance with the Listing Rules and other applicable legal and regulatory requirements and enable its directors to make a proper assessment of the applicant's financial condition and prospects; and</p> <p>c) the directors have the necessary experience, qualifications and competence. (Paragraph 17.4(c))</p>	<p>waived by the Stock Exchange);</p> <p>b) the listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant;</p> <p>c) the information in the non-expert sections is true in all material respects and does not omit material information;</p> <p>d) the listing applicant has established adequate procedures, systems and controls; and</p> <p>e) the directors have the necessary experience, qualifications and competence. (LR 3A.15)</p>
6.	<p>A sponsor should ensure that all material issues known to it which, in its reasonable opinion, are necessary for the consideration of whether the applicant is suitable for listing and whether the listing of the applicant's securities is contrary to the interest of the investing public or to the public interest are disclosed to the regulators when submitting a listing application. (Paragraph 17.4(d))</p>	–
7.	<p>A sponsor, after reasonable due diligence, should ensure that at the time of issue a listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant. (Paragraph 17.5(a))</p>	<p>A sponsor must confirm to the Stock Exchange on or before the date of issue of the listing document that the listing document contains sufficient particulars and information to enable a reasonable person to form a valid and justifiable opinion of the financial condition and profitability of the listing applicant. (LR 3A.15 and see paragraph 5(b) above)</p>
8.	<p>A sponsor, after reasonable due diligence, should have reasonable grounds to believe and does believe that at the time of issue of a listing document the information in the non-expert sections is true, accurate and complete in all material respects and that there no material omissions. (Paragraph 17.5(b))</p>	<p>A sponsor must confirm to the Stock Exchange on or before the date of issue of the listing document that the information in the non-expert sections contains all information required by relevant legislation and rules, is true in all material respects and does not omit material information. (LR 3A.15 and see paragraph 5(c) above)</p>
9.	<p>At the time of issue of a listing document, a sponsor should be in a position to demonstrate that it is reasonable for it to rely on the expert sections of the listing document. (Paragraph 17.5(c))</p>	–
10.	<p>In order for a sponsor to demonstrate that it is reasonable for it to rely on an expert report of a listing document, typical steps the sponsor should take in connection with the expert report include, among other things:</p> <p>a) the sponsor confirming that expert is appropriately qualified and experienced, the bases and assumptions adopted by the expert are fair and reasonable, the expert's</p>	–



	Proposed Provision	Existing requirement (source rule)
	<p>scope of work is appropriate to the opinion and the expert is independent from the listing applicant;</p> <p>b) the sponsor ensuring that factual information on which an expert relies is consistent with the sponsor's knowledge of the applicant including that derived from its other due diligence work;</p> <p>c) where factual information is solely or primarily derived from management's representations and confirmations, the sponsor, unless the expert has done so, making independent inquiries or assessments or obtaining independently sourced information to verify the accuracy and completeness of the information; and</p> <p>d) the sponsor corroborating information obtained from different sources to ensure it is consistent.</p> <p>(Paragraph 17.6(g))</p>	
11.	<p>When seeking assistance from third parties, a sponsor remains responsible for the overall due diligence exercise. In particular a sponsor should:</p> <p>a) assess whether the third party is appropriately qualified and competent for the tasks assigned to it;</p> <p>b) determine the scope and extent of tasks to be performed by the third party;</p> <p>c) assess the results of the work performed by the third party and arrive at its own opinion whether the work provides a sufficient basis to determine that reasonable due diligence has been conducted and whether further due diligence is required; and</p> <p>d) assess whether the results of the work should be incorporated in the listing document or brought to the attention of regulators.</p> <p>(Paragraph 17.6(h))</p>	<p>It may be appropriate for a sponsor to engage third party professionals to assist it to undertake tasks related to certain due diligence inquiries. For example, assistance in reviewing the circumstances of all current legal proceedings to which the new applicant is a party. In such cases, the Exchange expects the sponsor to satisfy itself that it is reasonable to rely on information or advice provided by the third party professional. That would include, for example: (a) being satisfied as to the competence of the professional, the scope of work to be undertaken by the professional and the methodology proposed to be used by the professional; and (b) being satisfied that the third party professional's report or opinion is consistent with the other information known to the sponsor about the new applicant, its business and its business plans. (PN21 (5))</p>
12.	<p>A sponsor should reasonably satisfy itself that all information provided to the Stock Exchange and the SFC during the listing application process is accurate, complete and not misleading and, if it becomes aware that the information provided does not meet this requirement, the sponsor should inform the Stock Exchange and the SFC (as the case may be) promptly. In addition, a sponsor should deal with all enquires raised by the regulators in a cooperative, truthful and prompt manner.</p> <p>(Paragraph 17.7(a) and (b))</p>	<p>Each sponsor must undertake to use reasonable endeavours to ensure that all information provided to the Stock Exchange is true in all material respects and does not omit any material information; and to the extent that the sponsor subsequently becomes aware of information that casts doubt on the truth, accuracy or completeness of information provided to the Stock Exchange, it will promptly inform the Stock Exchange of such information. Each sponsor should cooperate in any investigation conducted by the Stock Exchange, including answering promptly any questions and</p>



	Proposed Provision	Existing requirement (source rule)
		producing promptly the relevant documents. (LR 3A.04)
13.	A sponsor should disclose to the Stock Exchange in a timely manner any material information relating to a listing applicant or listing application of which it becomes aware which concerns non-compliance with the Listing Rules or other applicable legal or regulatory requirements. If a sponsor ceases to act for a listing applicant during the listing application process, it is required to inform the Stock Exchange in a timely manner of the reasons for ceasing to act. (Paragraphs 17.7(c) and (d))	Where a CFA becomes aware that its client is not complying with the regulatory requirements, it should advise its client to bring the matter to the attention of the regulators at the earliest opportunity. If this is declined by the client without valid reasons, it should consider the need to cease to act. When asked by the regulators about a possible breach of a relevant regulation (whether committed by itself or its client), a CFA should respond to the regulators in a cooperative and truthful manner (to the best of its knowledge). (CFA Code 6.3)
14.	A sponsor's records should be sufficient to demonstrate that the sponsor has complied with all applicable legal and regulatory requirements and in particular compliance with the Provisions. (Paragraphs 17.8(a))	A CFA should maintain proper books and records, and be able to provide a proper trail of work done upon request by the SFC. (CFA Code 2.3)
15.	A complete set of a sponsor's records in connection with a listing transaction should be retained in Hong Kong for at least seven years after completion or termination of the transaction. (Paragraph 17.8(b))	–
16.	Before accepting any appointment as a sponsor, a firm should ensure that, taking account of other commitments, it has sufficient staff with appropriate levels of knowledge, skills and experience to devote to the assignment throughout the period of the assignment. (Paragraph 17.9(a))	A licensed or registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities. (Code of Conduct GP3) The Management has the overall responsibility to ensure that there are sufficient staff to carry out the work throughout the period when the firm acts as a sponsor. The level of human resources and expertise should be commensurate with the volume, size, complexity and nature of the sponsor work that is undertaken by the sponsor. (Sponsor Guidelines 1.1.5 and 1.1.6).
17.	Taking account of the volume, size, complexity and nature of the sponsor work required to be undertaken in respect of each assignment, a sponsor should appoint a team comprising staff with appropriate levels of knowledge, skills and expertise (which should include at least one Principal) to carry out the sponsor assignment throughout the period of the assignment. (Paragraph 17.9(b))	When a firm takes up an appointment as a sponsor pursuant to the requirements under the Listing Rules, the Management should appoint a team comprising corporate finance staff, including at least a Principal who acts as the supervisor of the team, to carry out each sponsor engagement. (Paragraphs 1.1.3, 1.1.5, 1.1.6, 1.2.4 and 1.2.5 of the Sponsor Guidelines)



	Proposed Provision	Existing requirement (source rule)
18.	A sponsor should maintain effective systems, controls and procedures to ensure an appropriate due diligence plan is formulated, updated as necessary and implemented in respect of each assignment and there are clear and effective reporting lines so that key issues are escalated to Management for deliberation. (Paragraph 17.9(c)-(d))	An effective management and organisational structure which ensures that the operations of the business are conducted in a sound, efficient and effective manner shall be established and maintained. (Part 1 of the Internal Control Guidelines)
19.	A sponsor's Management is obliged to assume full responsibility for the sponsor's operations and to supervise key issues including but not limited to: (a) accepting a mandate to act as a sponsor; (b) monitoring the implementation of the due diligence plan; (c) ensuring that sufficient persons with appropriate levels of knowledge, skills and experience are devoted to each assignment over the period of the assignment; (d) reviewing the standard and extent of due diligence work, and the performance of the Principals and the Transaction Team; and (e) resolving suspicious circumstances, difficult or sensitive issues, conflicting information and material non-compliance. (Paragraph 17.9(e)-(f))	Management should assume full responsibility for the firm's operations including the development, implementation and on-going effectiveness of the firm's internal controls and the adherence thereto by its directors and employees. Reporting lines should be clearly identified, with supervisory and reporting responsibilities assigned to the appropriate staff members. (Part 1 of the Internal Control Guidelines)
20.	A sponsor should act as the overall manager of the public offer and ensure sufficient arrangements are in place so that the public offer is conducted in a fair and orderly manner. (Paragraph 17.10)	A CFA, acting as a sponsor, should act as the overall manager to manage the public offer process and ensure sufficient arrangements are in place so that the public offer is conducted in a fair and orderly manner. (CFA Code 5.3 and 5.4).
21.	The sponsor should take reasonable steps to ensure that all material information, including forward-looking information (whether quantitative or qualitative) disclosed or provided to analysts is contained in the relevant listing document. (Paragraph 17.11)	The CFA should take reasonable steps to ensure that all material information, including forward-looking information (whether quantitative or qualitative) disclosed or provided to analysts is contained in the relevant listing document. (CFA Code 5.10)



Personal information collection statement

1. 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 your Personal Data¹ 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 Personal Data (Privacy) Ordinance, Cap. 486 (**PDPO**).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes;
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this 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's website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. 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 this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

² Defined in Schedule 1 to the Securities and Futures Ordinance (Cap. 571) to mean provisions of the Securities and Futures Ordinance and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this 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
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.