

## ▶ Recent developments in the regulation of Sponsors

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September 2005

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# INTRODUCTION

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2 stages in tightening of the sponsor regulatory regime:

- Amendments to the Listing Rules including a new Practice Note on Due Diligence by Sponsors effective 1 January 2005
- Proposals for a specific regulatory regime for sponsors under the SFO set out in the SFC's June 2005 Consultation Paper on the Regulation of Sponsors and Compliance Advisers

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**LISTING RULE AMENDMENTS  
EFFECTIVE 1 JANUARY 2005**

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## New Requirements for Sponsors

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- New Chapter on Sponsors and Compliance Advisers (Chapter 3A Main Board Rules and Chapter 6A GEM Rules)
- New Practice Note on Due Diligence to be performed by Sponsors (Practice Note 21 Main Board Rules and Practice Note 2 GEM Rules)
- (At least ) one Sponsor must be appointed to assist new applicant with IPO
- If more than one sponsor, all are responsible

## New Requirements for Sponsors (Cont'd)

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- At least one Sponsor must be independent of the applicant in accordance with new independence test at Main Board Rule 3A.07 and GEM Rule 6A.07
- Each Sponsor must submit a Statement Relating to Independence to the Exchange (MB Rules Appendix 18/ GEM Rules Form K of Appendix 7)
- Sponsors must undertake to the Exchange to comply with the Listing Rules, ensure the accuracy of information and co-operate in any investigation

## New Requirements for Sponsors (Cont'd)

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### Sponsors' Obligations (MB Rule 3A.11/GEM Rule 6A.11)

Sponsors must:

- comply with the Sponsor's Undertaking
- be closely involved in the preparation of the listing document
- conduct reasonable due diligence inquiries
- have regard to the new Practice Note re. what is reasonable due diligence
- Practice Note sets out steps Exchange typically expects to be performed: actual steps may need to be more extensive

## New Requirements for Sponsors (Cont'd)

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### Sponsor's Declaration to the Exchange (MB Rule 3A.13/GEM Rule 6A.13)

Each Sponsor must submit a Declaration (Main Board Rules Appendix 19 and GEM Rules Form G of Appendix 7) covering due diligence re:

- the directors' declarations
- applicant's compliance with basic listing conditions
- the sufficiency of the listing document
- the applicant's systems and controls
- the directors' individual and collective experience, qualifications and competence

## New Requirements for Sponsors (Cont'd)

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the expert sections of the listing document including whether:

- factual information relied on but not verified by the expert is true and complete
- all bases and assumptions are fair reasonable and complete
- expert is appropriately qualified, experienced and sufficiently resourced
- appropriateness of expert's scope of work
- expert's independence
- that listing document fairly represents expert's views



# Practice Note on Due Diligence by Sponsors in respect of Initial Listing Applications : Practice Note 21 of MB Rules and Practice Note 2 of GEM Rules

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- Practice Note applies only to sponsor firms; not individuals
- Sets out steps Exchange typically expects to be performed: actual steps may need to be more extensive
- Requires sponsors to document (a) due diligence planning and significant deviations from plans and (b) conclusions as to applicant's compliance with listing conditions

## Termination of Sponsors (MB Rule 3A.17/GEM Rule 6A.17)

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On the resignation or termination of the sponsor:

- The listing applicant must immediately notify the Exchange
- If the departing sponsor is the sole independent sponsor, the replacement sponsor must immediately notify the Exchange of its appointment, re-submit a listing application, revised timetable, listing fee and sponsor declarations and undertakings
- A new sponsor is not regarded as having fulfilled any of its obligations by virtue of work performed by its predecessor

## Compliance Advisers

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All listed issuers must appoint a Compliance Adviser from the date of listing until:

- for **Main Board issuers** – publication of financial results for the **first** full financial year after listing
- for **GEM issuers** – publication of financial results for the **second** full financial year after listing
- MB Rule 3A.19/GEM Rule 6A.19

Compliance Advisers must act impartially but need not be independent

## Compliance Advisers (Cont'd)

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- The Exchange may require a listed issuer to appoint a Compliance Adviser at any other time for a period specified by the Exchange (MB Rule 3A.20/GEM Rule 6A.20)
- Normally where the issuer has breached the Listing Rules, eg. if breaches are persistent or serious or give rise to concerns as to the adequacy of compliance arrangements or the directors' understanding of the Listing Rules
- Issuer need not appoint the same Compliance Adviser as was appointed on listing

## Compliance Advisers (Cont'd)

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Compliance Advisers must:

- undertake to the Exchange to comply with the Listing Rules and cooperate in any investigation
- advise and guide the issuer in the 4 situations in which the issuer must consult its CA
- when consulted, ensure the issuer is properly guided and advised
- specific obligations on review of the issuer's financial reports and on a proposed change in use of the IPO proceeds

## Compliance Advisers (Cont'd)

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Issuers must consult their Compliance Adviser:

- before publication of any regulatory announcement or report, circular or financial report
- where a notifiable or connected transaction is contemplated (including share purchases and share repurchases)
- where the issuer proposes to use IPO proceeds other than as set out in the Listing Document or where its business activities, developments or results differ from information in the Listing Document
- where the Exchange makes an inquiry as to unusual movements in the price or trading volume of the issuer's securities

MB Rule 3A.23/GEM Rule 6A.23

## Termination of Compliance Adviser (MB Rule 3A.26/GEM Rule 6A.26)

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- A listed issuer can only terminate its Compliance Adviser if its work is unacceptable or there is a material dispute over fees which cannot be resolved within 30 days
- A replacement must be appointed within 3 months of a Compliance Adviser's resignation or termination

## Independent Financial Advisers (“IFAs”)

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- New Rules added to MB Chapter 13 and GEM Chapter 17
- IFAs must be independent in accordance with new test at MB Rule 13.84 and GEM Rule 17.96
- IFAs must submit a Declaration of Independence
- IFAs must undertake to the Exchange to comply with the Listing Rules and cooperate in any investigation



## IFAs (Cont'd)

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### IFA's Obligations

An IFA must take all “reasonable steps” to be satisfied that:

- it has a reasonable basis for making the statements required; and
- there is no reason to believe that any information relied on is not true or omits a material fact

### IFA'S Due Diligence

Note 1 to MB Rule 13.80/GEM Rule 17.92 sets out a non-exhaustive list of expected “reasonable steps”

### Issuer's Obligation to Assist IFA

An issuer required to appoint an IFA must:

- give the IFA access to all persons, premises and documents relevant to performance of the IFA's duties;
- inform the IFA of material changes to information accessed by the IFA;
- obtain necessary consents for providing information to the IFA;

Experts' terms of engagement should give IFAs access to the expert, its reports, information relied on, correspondence etc.

# **Proposed New Regulatory Regime for Sponsors under The Securities and Futures Ordinance**

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**PROPOSALS SET OUT IN SFC'S JUNE 2005  
CONSULTATION PAPER ON THE REGULATION OF  
SPONSORS AND COMPLIANCE ADVISERS**

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# Proposed New Regulatory Regime for Sponsors under The Securities and Futures Ordinance

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- Sponsors will still have to satisfy existing licensing eligibility criteria for Regulated Activity Type 6 (Advising on Corporate Finance) and comply with existing SFC Codes and Guidelines
- Proposals will add specific eligibility criteria and on-going compliance obligations for sponsors

# Proposed Additional Licensing Eligibility Criteria for Sponsors

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Additional criteria for determining whether a sponsor is “fit and proper” include:

- The firm must have sufficient expertise and resources to perform sponsor work
- Management must be responsible for all sponsor work
- Each transaction must be staffed by a “transaction team” with the right mix of skills and expertise and supervised by a “Principal”
- Firms must have “sufficient” Principals to discharge sponsor work: minimum requirement for 2 Principals;

## Proposed Additional Licensing Eligibility Criteria for Sponsors (Cont'd)

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- ▶ A Principal must be a Responsible Officer licensed for Regulated Activity Type 6 who has:
  - a minimum of 5 years' relevant corporate finance experience; and
  - played a substantial role in at least 2 completed IPOs in the 5 years immediately before his appointment

The experience requirements are initial eligibility criteria only.

“Relevant corporate finance experience” means the person must have experience in one or more of the following areas: IPOs, notifiable transactions, a rights issue or open offer by a listed company and takeovers subject to the Takeovers Code.

## Proposed Additional Licensing Eligibility Criteria for Sponsors (Cont'd)

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- ▶ Firms must have effective systems and internal controls to ensure:
  - adequate supervision and management of employees conducting sponsor work;
  - employees do not exceed their authority;
  - regulatory compliance

There must be effective reporting lines between transaction teams and management

# Proposed Additional On-going Compliance Obligations for Sponsors

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## Internal Assessment and Annual Return to SFC

- Sponsors will have to conduct an annual self-assessment of their compliance with the requirement for effective systems and controls
- Any material non-compliance will have to be reported promptly to the SFC
- The Annual Return filed with the SFC under s138 SFO will have to confirm the conduct of the internal assessment

## Record Keeping

Lists of all sponsor work undertaken (including the composition of transaction teams) will be have to be kept.



# Proposed Additional On-going Compliance Obligations for Sponsors (Cont'd)

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## Continuing Professional Training

At least 50% of CPT hours must be spent on corporate finance, particularly IPO matters, and Hong Kong listing matters and regulatory knowledge.

## Minimum Capital Requirement and Professional Indemnity

There will be a minimum capital requirement of HK\$ 10 million for all sponsors.

The SFC has proposed that sponsors should have professional indemnity insurance for liabilities arising from sponsor work and asked for comments as to the amount of minimum coverage.

## Compliance Advisers

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It is proposed that only firms qualified as Sponsors under the proposals will be eligible to act as Compliance Advisers to newly listed issuers.

## Effective Date

The proposed effective date will be 12 months after publication of the Consultation Conclusions.

Firms with an IPO track record (ie. who have advised on at least one completed IPO in the 5 years immediately before the effective date) will need to file a confirmation with the SFC that they meet the additional requirements on the effective date.

Firms with no IPO track record will need to file with the SFC a confirmation that they meet the new requirements on the effective date together with evidence of compliance (eg. details of Principals' experience).

Non-qualifying firms will not be eligible to conduct sponsor or compliance adviser work after the effective date but can conduct all other types of corporate finance adviser work under their Type 6 licence.

**CHARLTONS**  
易周律师行

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## Contact us

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### Hong Kong Office

12<sup>th</sup> Floor  
Dominion Centre  
43 – 59 Queen's Road East  
Hong Kong

Telephone: (852) 2905 7888  
Fax: (852) 2854 9596  
Email: [enquiries@charltonslaw.com](mailto:enquiries@charltonslaw.com)  
Website: <http://www.charltonslaw.com>



CHARLTONS  
易周律師行

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## Other Locations

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### China

#### **Beijing Representative Office**

3-1703, Vantone Centre  
A6# Chaowai Avenue  
Chaoyang District  
Beijing  
People's Republic of China  
100020

Telephone: (86) 10 5907 3299  
Facsimile: (86) 10 5907 3299  
[enquiries.beijing@charltonslaw.com](mailto:enquiries.beijing@charltonslaw.com)

### Myanmar

#### **Yangon Office of Charltons Legal Consulting Ltd**

161, 50<sup>th</sup> Street  
Yangon  
Myanmar  
[enquiries.myanmar@charltonslaw.com](mailto:enquiries.myanmar@charltonslaw.com)

#### **Shanghai Representative Office**

Room 2006, 20th Floor  
Fortune Times  
1438 North Shanxi Road  
Shanghai  
People's Republic of China  
200060

Telephone: (86) 21 6277 9899  
Facsimile: (86) 21 6277 7899  
[enquiries.shanghai@charltonslaw.com](mailto:enquiries.shanghai@charltonslaw.com)

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