

► **Sponsors –**
The Regulatory Regime



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Introduction

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
- A specific regulatory regime for sponsors under the SFO which came into effect on 1 January, 2007

The Regulatory Regime for Sponsors under The SFO

- ▶ Sponsors must still satisfy the licensing eligibility criteria for Regulated Activity Type 6 (Advising on Corporate Finance) and comply with existing SFC Codes and Guidelines

- ▶ The Additional Fit and Proper Guidelines for Sponsors and Compliance Advisers (Appendix I of the Fit and Proper Guidelines) contain:
 - New specific eligibility criteria for sponsors; and

 - On-going compliance obligations.

The Regulatory Regime for Sponsors under The SFO (Cont'd)

- Only firms who demonstrate compliance with the new eligibility criteria are eligible to conduct sponsor and compliance adviser work.
- Eligible firms wishing to act as sponsors have to comply with on-going obligations.
- Firms that do not meet the new criteria or do not want to conduct sponsor work are imposed with a no-sponsor work licensing condition. This also prevents them from acting as a compliance adviser.
- According to the SFC, only 84 Type 6 licensed intermediaries are now permitted to act as sponsors. A no-sponsor work condition was imposed on the other 183 Type 6 licensed intermediaries.

The Regulatory Regime for Sponsors under The SFO (Cont'd)

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;

Eligibility Criteria for Principals

- ▶ 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 on MB or GEM 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 or connected transactions, a rights issue or open offer by a listed company, takeovers and share repurchases subject to the Codes on Takeovers, Mergers and Share Repurchases and any other significant transactions or equity-fund raising exercises.

Eligibility Criteria for Principals (Cont'd)

- A majority of the “relevant corporate finance experience” must be from transactions involving equity fund raising from the public. Some of that experience may have been obtained in overseas markets with comparable legal and regulatory standards.
- The 2 completed IPOs must have been on the Hong Kong Main Board or GEM. Overseas IPO experience will not be recognised.
- Principals must be appointed by board resolution.
- The sponsor firm must submit Supplement 10(s) (Experience of Principal) completed by the Principal and endorsed by the sponsor within 7 business days of a Principal’s appointment.
- The SFC must be notified in writing within 7 business days of the cessation of a Principal’s appointment.

Internal Controls

- ▶ 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; and
 - regulatory compliance.

Minimum Paid-up Capital Requirement

- ▶ Sponsors must have a minimum paid-up capital of HK\$10 million.

Additional On-going Compliance Obligations for Sponsors

Management Responsibility

One of the core requirements is that the Management of a sponsor must be ultimately responsible for:

- the supervision of the sponsor work undertaken; and
- regulatory compliance.

“Management” includes the firm’s Board of Directors, Managing Director, Chief Executive Officer, Responsible Officers and other senior management personnel.

Management must maintain effective communication with staff at the operational level to ensure that it is kept abreast of any key issues and risk areas in relation to the firm’s sponsor work.

Transaction Teams

- ▶ Management must appoint a team of corporate finance staff (“Transaction Team”) to each IPO transaction;
- ▶ A Transaction Team must have the manpower, expertise and HK regulatory experience appropriate to the size, complexity and nature of the transaction;
- ▶ A Transaction Team must be supervised by at least one Principal;
- ▶ A Principal may supervise more than one Transaction Team if:
 - each team is adequately supervised; and
 - there is no conflict of interest.

Principals' Responsibilities

- ▶ A Principal supervises the work of one or more Transaction Teams;

- ▶ The Principal should be:
 - involved in the making of the key decisions in relation to a sponsor engagement;
 - aware of the key risks and responsible for the measures to address them; and
 - fully conversant with key issues and able to respond promptly to regulators' requests.

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements

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

The Sponsor must submit to the Exchange a Declaration (Appendix 19 of the Main Board Rules and Form G of Appendix 7 of the GEM Rules) confirming that, on the basis of its due diligence, it has reasonable grounds to believe that:

- the information given in the directors' declarations is accurate;
- the applicant satisfies the listing conditions;
- the information in the prospectus is sufficient to enable investors to form a valid opinion of the shares and the financial condition and profitability of the applicant;

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements (Cont'd)

- the non-expert sections of the prospectus contain all information required by relevant legislation and rules (including the listing rules);
- the information in the non-expert sections of the prospectus is true in all material respects and does not omit any material information;
- the applicant has established adequate systems and controls to enable it to comply with the Listing Rules (in particular the rules governing disclosure of price sensitive information, notifiable and connected transactions and the reporting of financial information); and
- the applicant's directors have the experience and understanding of the Listing Rules' requirements to ensure the applicant's compliance with the Listing Rules.

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements (Cont'd)

With respect to the expert sections of the prospectus, the Sponsor must declare, based on its due diligence, that it has reasonable grounds to believe that:

- any material factual information relied on but not verified by the expert is true in all material respects and does not omit any material information;
- the expert's bases and assumptions are fair, reasonable and complete;
- the expert is appropriately qualified, experienced and has sufficient resources to give the opinion;
- the scope of work is appropriate to the opinion required;
- the expert is independent; and
- the prospectus fairly represents the expert's view.

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements (Cont'd)

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

- 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) their due diligence planning;
 - b) significant deviations from their plans; and
 - c) their conclusions as to the applicant's compliance with the listing conditions.

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements (Cont'd)

In relation to the conduct of due diligence on a listing applicant, the Principal must:

- determine the depth and breadth of the due diligence;
- assess the resources required;
- make a critical assessment of the results;
- make an overall assessment of the adequacy of the due diligence review; and
- ensure that steps are taken to resolve all issues arising from the review.

Principals' Responsibilities in relation to Due Diligence : Listing Rule Requirements (Cont'd)

Key to the performance of the sponsor's responsibilities is the existence of effective communication lines and reporting responsibilities to ensure that key information, issues and risk areas that come to light during the course of due diligence are:

- reported by Transaction Team members to the responsible Principal; and
- notified to other members of Management.

Principals' Responsibilities

Under Listing Rule amendments effective on January 1, 2007, the Principal(s) most actively involved in an IPO transaction must sign relevant documents.

For a Main Board Listing

- Form A1;
- Form B: Declaration and Undertaking with Regard to Directors;
- Form C1: Formal Application; and
- Sponsor's Declaration (Appendix 19 to the Listing Rules)

For a GEM Listing

- Form A: Application Form; and
- Sponsor's Declaration (Form G of Appendix 7 to the GEM Rules).

Internal Assessment

- Sponsors must conduct an annual self-assessment of their compliance with the requirement for effective systems and controls
- Any material non-compliance issue must be reported promptly to the SFC

Record Keeping

A list of all sponsor work undertaken must be kept.

This must include :

- the names of the companies being advised;
- the composition of transaction teams (including variations); and
- the title and role of each team member.

Record Keeping (Cont'd)

Records must also be kept of:

- the appointment of the transaction team for each engagement;
- the appointment of a responsible officer or executive officer as Principal, the cessation of such appointment and the decision making process behind the appointment; and
- the annual assessment of internal systems and controls.

Continuing Professional Training

- ▶ At least 50% of CPT hours must be spent on matters relevant to sponsor work.

Minimum Capital Requirement

- ▶ Sponsors must maintain minimum paid-up capital of HK\$10 million.

Compliance Advisers

- ▶ Only firms qualified as Sponsors under the new regime are eligible to act as Compliance Advisers to newly listed issuers.

Commission Inspections

- ▶ Sponsors and Compliance Advisers will be subject to on-going supervision by the SFC.
- ▶ SFC will be entitled to inspect both on a routine and ad hoc basis.

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