Charltons - Hong Kong Law Newsletter - 13 May 2004

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# Proposed Amendments To The Listing Rules Relating To The Regulation Of Sponsors And Independent Financial Advisers

## Introduction

The Stock Exchange of Hong Kong (the **Exchange**) published draft amendments to the Main Board and GEM Listing Rules relating to the regulation of sponsors and independent financial advisers (**IFAs**) on May 4, 2004. Sponsors and IFAs have been invited to comment on the draft amendments by May 18, 2004. The proposed amendments follow market consultation carried out by the Exchange and the Securities and Futures Commission (the **SFC**) on the original proposals contained in their joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers published in May 2003 (the **Consultation Paper**). The draft amendments are available on the Exchange website: [www.hkex.com.hk](http://www.hkex.com.hk/).

The proposed amendment of the Listing Rules, together with the introduction of a new practice note on the required standard of sponsors' due diligence, form the first of two-stages reforming the regulation of sponsors and IFAs. The second stage will involve changes to the regulation of sponsors by the Securities and Futures Commission with particular emphasis on eligibility criteria, on-going supervision and enforcement. The SFC is expected to publish a consultation paper on these changes in the fourth quarter of 2004. The Consultation Paper's original proposal that the Exchange should administer a new regime establishing the acceptability of corporate finance advisers to act as sponsors or IFAs to new applicants or listed issuers on the Main Board and GEM has been abandoned.

The Exchange intends to publish the amended Listing Rules by the end of June 2004 for implementation from October 1, 2004. The Consultation Conclusions report on the Consultation Paper will be published simultaneously with the amended Rules.

The purpose of this note is to summarise the principal proposed amendments to the Rules. To view our summary of the Consultation Paper's original proposals, please see the schedule hereto.

## Appointment Of Sponsors

New Chapters relating to sponsors will be inserted into the Main Board and GEM Listing Rules as Chapters 3A and 6A, respectively.

### Initial Sponsors

New applicants are required to appoint an Initial Sponsor to assist on their initial listing applications (including a deemed new listing).

### Continuing Sponsors

All issuers, including all Main Board issuers (rather than just H-share issuers as is currently required) will be required to continue to have a sponsor appointed for a transitional period after listing. It is proposed that the period will end on publication of the financial results for the first full financial year after listing for both Main Board and GEM issuers. This is a new requirement for Main Board issuers (other than H-share issuers). The continuing sponsor need not be the IPO sponsor. There is an exemption from the requirement to appoint a continuing sponsor for issuers having at least 2 directors and a full-time compliance officer with the required corporate finance advisory experience.

The Exchange will also be entitled to direct a listed issuer to appoint a continuing sponsor at any other time, as it is already entitled to do in the case of GEM issuers under Rule 6.02. According to the draft Rules the Exchange is likely to exercise this right where a listed issuer has breached the Listing Rules, particularly where the breaches are persistent or serious or raise concerns as to the adequacy of compliance arrangements or the directors' understanding of the Listing Rules. The continuing sponsor appointed need not be the IPO sponsor or any previously appointed continuing sponsor.

During the prescribed period, issuers will be obliged to seek the continuing sponsor's advice on the publication of any regulatory announcement, circular or financial report; where a notifiable transaction (including a connected transaction) is contemplated including share issues and repurchases; where the listed issuer proposes to use IPO proceeds other than in the manner described in the listing document or where its business activities, developments or results deviate from those detailed in the listing document.

### Sponsors' Eligibility

The Main Board Rules define initial and continuing sponsors as corporations or authorized financial institutions acceptable to the Exchange that are licensed or registered by the SFC to advise on corporate finance matters (ie. licensed or registered under Part V Securities and Futures Ordinance to conduct Regulated Activity Type 6). The Exchange expects to amend this definition to remove the Exchange's discretion and refer to the revised eligibility criteria once the revised SFC licensing regime under the SFO is in place which is expected to be in 2005. The GEM Rules will refer to entities being on the GEM list of sponsors rather than those 'acceptable to the Exchange'.

### Number of Initial Sponsors

Listing applicants may appoint more than one Initial Sponsor. Where more than one is appointed, all are jointly and severally responsible for the discharge of the Initial Sponsor's duties set out in the Listing Rules. One of the Initial Sponsors must also be designated as the primary channel of communication for communications with the Exchange relating to the listing.

## Independent Financial Advisers

New Rules relating to IFAs will be inserted in Main Board Chapter 13 and GEM Chapter 17.

## Impartiality Of Sponsors And IFAs

Sponsors and IFAs are required to be impartial in performing their duties and to avoid relationships or connections with the new applicant or listed issuer that would compromise their objectivity.

## Independence Of Sponsors And IFAs

Where only one Initial Sponsor is appointed, that sponsor must be independent of the new applicant. Where a new applicant appoints more than one Initial Sponsor, at least one must be independent of the applicant. A Continuing Sponsor must be independent of the listed issuer. All IFAs are required to be independent of the listed issuer.

The draft Rules contain a list of circumstances in which a proposed sponsor or IFA will not be regarded as independent of the issuer. These are set out in draft Rules 3A.09 and 13.84.

Sponsors and IFAs will be required to give a declaration of their independence from the new applicant or listed issuer.

## Due Diligence

### Sponsors

The Exchange has dropped what was probably the most controversial of the Consultation Paper's original proposals, that the sponsor and lead underwriter should give a declaration in the prospectus as to the due diligence performed in providing the Exchange with assurances of the completeness and accuracy of the prospectus.

Instead, each Initial Sponsor will be required to submit a declaration to the Exchange containing a number of confirmations set out at Rule 3A.17 which include the following:

* that all documents required to be submitted in connection with the listing have been submitted;
* that having made reasonable due diligence enquiries, the Initial Sponsor has reasonable grounds to believe and does believe that:
	1. the new applicant complies with all the qualifications for listing and has adequate procedures and systems to ensure its compliance with the Listing Rules; and
	2. the answers provided by the applicant's directors in their directors' declarations would not cause a reasonable person with the experience and skills of a competent sponsor to inquire further; and
* confirmations relating to the information in both the expert and non-expert sections of the listing document.

Specific confirmations are required:

* with respect to the non-expert sections of the listing document, that having made reasonable due diligence inquiries, the Initial Sponsor has reasonable grounds to believe and does believe that it:
	1. contains all information required by relevant legislation, codes etc.;
	2. is true in all material respects; and
	3. does not omit material information necessary in order to make such information not misleading; and
* with respect to the expert sections, that the Initial Sponsor has no reasonable grounds to believe and does not believe that the statements are untrue or omit to state a material fact required to be stated or necessary to make the statements not misleading.

#### New Practice Note on Sponsors' Due Diligence

Sponsors will be required to have regard to a new practice note 'Due Diligence by Sponsors in respect of Initial Listing Applications' (Appendix B to the draft amendments) in determining what are reasonable due diligence inquiries. This practice note replaces the draft Code contained in the Consultation Paper. The draft practice note stresses that the guidance given is only as to the due diligence sponsors will typically perform and that the adequacy and extent of due diligence will always depend on the particular circumstances. In relation to the non-expert sections of listing documents, the essence of the guidance is that sponsors must conduct their own investigations rather than take information provided by management at face value.

The practice note applies only to sponsor firms and not to IFAs or individuals.

##### IFAs

The Rules will also require IFAs to conduct due diligence, for example, to satisfy themselves that there are no reasonable grounds to believe that any information, expert advice or opinion relied on by the IFA in relation to a transaction or arrangement is not true, is potentially misleading or omits a material fact. Examples of due diligence the Exchange would typically expect are set out in the notes to Rule 13.80.

Please note that this memorandum is for general information purposes only. Specific legal advice should be sought in relation to any particular situation.

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**Charltons - Hong Kong Law Newsletter - Issue 12 - 13 May 2004**