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# New Sponsor Requirements To Take Effect January 1, 2007

## Introduction

New eligibility criteria and on-going obligations for sponsors will be implemented by the SFC with effect from January 1, 2007. Under the new regime, only corporate advisory firms meeting the new eligibility criteria will be allowed to act as sponsors and compliance advisers. Eligible firms who wish to conduct sponsor work will also have to comply with specific on-going obligations. Firms not meeting the new criteria will be imposed with licensing conditions restricting them from undertaking sponsor work which will also prevent them from conducting compliance adviser work.

Corporate advisory firms (i.e. firms holding a licence for Regulated Activity Type 6 (advising on corporate finance) (“RA 6”)) must notify the SFC whether they wish to continue conducting sponsor work prior to September 30, 2006. The SFC will provide forms for existing firms to indicate their intentions in due course. Firms wishing to act as sponsors must comply with the new requirements by January 1, 2007. If the SFC is satisfied that a firm is eligible to act as a sponsor, it will notify the firm of its decision not to impose a no-sponsor work licensing condition and the firm will be entitled to rely on its existing RA 6 licence to conduct sponsor work. New licences will not be issued.

The new requirements will be set out in The Guidelines for Sponsors and Compliance Advisers (the “Sponsor Guidelines”) which will form part of the Fit and Proper Guidelines. The new regime forms the second of the two-stage initiative by the SFC and the Stock Exchange of Hong Kong (the “Exchange”) to tighten the regulation of sponsors.

The Sponsor Guidelines are set out in Annex 1 to the Consultation Conclusions to the Consultation Paper on the Regulation of Sponsors and Compliance Advisers which are available on the [SFC website](http://www.sfc.hk/web/EN/index.html). The Sponsor Guidelines adopt all the proposals put forward in the SFC’s June 2005 Consultation Paper with the exception of the proposal on mandatory professional indemnity insurance coverage for all sponsors and the proposal for annual confirmation to the SFC that the required assessment of internal controls has been conducted.

The purpose of this note is to summarise the new requirements.

## A. Eligibility Criteria For Sponsors

The Guidelines introduce specific eligibility criteria for corporate finance advisory firms that wish to act as sponsors. These requirements are in addition to the existing general requirements applicable to corporate finance advisory firms licensed under Type 6 Regulatory Activity. Sponsors must also comply with the existing SFC guidelines, namely the Fit and Proper Guidelines, the Guidelines on Competence, the Code of Conduct for Persons Licensed by or Registered with the Commission and the Corporate Finance Adviser Code of Conduct.

Corporate advisory firms who meet the criteria will be able to carry out sponsor work and will have to comply with the specific on-going compliance requirements set out in the Sponsor Guidelines. Firms that cannot meet the eligibility criteria will be imposed with licensing conditions restricting them from carrying out sponsor activities. Such restriction will also prevent them from conducting compliance adviser work (see section C below).

It is proposed that the existing Listing Rules relating to the eligibility of sponsors and compliance advisers will be removed once the new SFC eligibility criteria take effect.

A firm must meet the following criteria in order to be qualified as a sponsor and remain eligible as such:

### 1. Experience and Expertise in Sponsor Work

The Sponsor’s Management is ultimately responsible for the supervision of the sponsor work carried out by the firm and compliance with all relevant rules, regulations, codes and guidelines. A firm’s “Management” includes its Board of Directors, Managing Director, Chief Executive Officer, Responsible Officers and other senior management personnel.

### 2. Management Supervision and Responsibility

The Sponsor’s Management is ultimately responsible for the supervision of the sponsor work carried out by the firm and compliance with all relevant rules, regulations, codes and guidelines. A firm’s “Management” includes its Board of Directors, Managing Director, Chief Executive Officer, Responsible Officers and other senior management personnel.

### 3. Transaction Teams and Appointment of Principals

Whenever a firm takes up an appointment as a sponsor, the Management is required to appoint a team (a “transaction team”) comprising corporate finance staff competent in the context of the work to be carried out by the team.

Sponsors must have sufficient Principals to supervise their transaction teams and must have a minimum of 2 Principals at all times. At least one Principal must supervise each transaction team formed to undertake sponsor work.

To qualify as a Principal, an individual must:

1. be a Responsible Officer (“RO”);
2. have at least 5 years’ relevant corporate finance experience in respect of companies listed on the Main Board and/or GEM Board preceding the appointment as Principal;
3. have played a substantial role in supervising a listing applicant as sponsor in at least 2 completed IPOs on the Main Board and/or the GEM Board in the 5 years immediately preceding his appointment.

#### *5 Years’ Relevant Corporate Finance Experience*

For the purposes of condition (ii), relevant “corporate finance experience” may be made up of experience acquired in **one or more** of the following activities:

1. IPOs
2. notifiable or connected transactions as defined in the Exchange’s Listing Rules;
3. a rights issue or open offer by a listed company in accordance with the Exchange’s Listing Rules;
4. takeovers and share repurchases subject to the Codes on Takeovers and Mergers and Share Repurchases; and
5. any other significant transactions or equity-fund raising exercises not listed in the above.

The 5 years’ corporate finance experience may be made up of experience acquired in one or more of the specified activities and need not be experience gained solely from IPOs. However, a majority of the relevant experience must have been acquired from transactions having an element of equity-fund raising by the listed issuers from the public and that experience must be sufficiently recent.

Some (but not all) of the 5 years’ corporate finance experience may have been acquired in markets outside Hong Kong provided that those markets have comparable or higher legal and regulatory standards for the listing of companies and public offers of securities, regulate the conduct of sponsors or their equivalents and enforce rules and regulations governing these areas. If a person’s experience has been acquired mainly overseas, he will need to satisfy the SFC that the relevant corporate finance experience requirement has been met.

#### *IPO Experience*

Experience on overseas IPOs will not satisfy the requirement that the Principal must have played a substantial role in supervising a listing applicant in 2 completed IPOs. The 2 completed IPOs must have been on the Hong Kong Main Board or GEM Board.

A “substantial role” in this context means a leading, supervisory role. The 2 IPO requirement need only be satisfied on a principal’s initial appointment: it is not a continuing eligibility requirement.

On appointing an individual as a Principal, Management is required to provide a written endorsement on behalf of the licensed corporation that the individual meets the eligibility criteria.

A Principal is expected to be the decision maker on all key issues relating to work carried out by the transaction team and should be aware of the key risks in such work and responsible for measures to address them. For example, the Principal should be involved in determining the breadth and depth of due diligence conducted on a listing applicant and the amount of resources to be deployed for the due diligence exercise. The principal should also be involved in making a critical assessment of the results of the due diligence and an overall assessment of the adequacy of the due diligence review and ensuring that all issues arising from the review are resolved.

### 4. Internal Systems and Controls

Sponsor firms will be required to have effective internal systems and controls in place to ensure:

1. adequate supervision and management of their employees conducting sponsor work;
2. that employees do not act beyond their proper authority; and
3. compliance with all applicable laws, regulations, codes and guidelines, including the Exchange’s Listing Rules.

### 5. Financial Resources

Sponsors will be required to have a minimum paid-up capital of HK$10 million at all times. This requirement will be prescribed in the Financial Resources Rules (“FRR”). Prior to the amendment of the FFR, sponsors will be required to satisfy the SFC that they have met, or are in the position to meet, the minimum paid-up capital requirement.

## B. On-going obligations

The Sponsor Guidelines also impose the on-going obligations described below.

### 1. Internal Controls and Assessment

Sponsor firms are required to maintain effective systems and controls to ensure compliance with all relevant regulations, codes and guidelines. An assessment of internal systems and controls must be conducted annually to ensure that they remain effective. Any material non-compliance must be reported promptly to the SFC.

The annual assessment may be an external or internal assessment or audit which should focus on the effectiveness of the internal controls and supervision, including reporting lines and the due diligence process, and identify any key operational risks associated with sponsor work in the light of the transactions the firm has advised on as sponsor in the preceding 12 months. Given the differences in size and business model among sponsors, the SFC expects each sponsor to devise its own specific systems and controls in light of its business operations and to decide the scope of its annual assessment on the basis of those systems and controls.

The Sponsor Guidelines also require Management to maintain effective communication with staff at the operational level so that it is kept abreast of any key issues and risk areas relating to the firm’s sponsor work.

### 2. Records

Sponsors are required to keep a complete and up-to-date list of all sponsor work that has been and is being undertaken. The list should include the names of the companies advised, the nature of the transactions, the transaction team members and the title and role of each team member from start to finish. Such information must be made available to the SFC upon request.

Sponsors should also keep records of the following appointments and assessments made by Management in order to demonstrate compliance with the Sponsor Guidelines:

1. the appointment of the transaction team for each sponsor engagement;
2. the appointment of a RO as a Principal, the cessation of such an appointment and the decision-making process behind such appointment; and
3. the annual assessment of the sponsor’s internal systems and controls.

### 3. Continuing Professional Education

The Sponsor Guidelines stipulate that at least 50% of the CPT hours (currently 5) that ROs and licensed representatives are required to undertake annually as holders of a corporate finance adviser licence should relate to sponsor work, e.g. skills that are relevant to their role as sponsors and knowledge of the relevant regulatory rules and their changes.

## C. Compliance Advisers

The Sponsor Guidelines stipulate that corporate finance firms have to be eligible to act as sponsors under those guidelines (i.e. a firm must not have a licensing condition prohibiting it from conducting sponsor work) in order to act as compliance advisers under the Exchange’s Listing Rules. Accordingly, if any firm is imposed with a restriction that it cannot undertake sponsor work, it will also cease to be eligible to conduct compliance adviser work.

## D. Independent Financial Advisers

The new regulatory regime will not impose any additional regulations on independent financial advisers.

## E. Transitional Arrangements

The new regulatory regime will become effective on January 1, 2007(the “Effective Date”). Licensing conditions will be imposed on firms that do not meet the criteria for sponsors.

Corporate finance advisory firms that intend, or wish to continue, to act as sponsors and/or compliance advisers on or after the Effective Date must indicate their intentions to the SFC by September 30, 2006 and ensure their compliance with the new requirements by the Effective Date.

### New RA 6 licence applicants

Corporations that have not applied for a RA 6 licence prior to the Effective Date but wish to carry out sponsor work on or after the Effective Date should submit applications for RA 6 licences, with documentation demonstrating their compliance with the specific eligibility criteria under the Sponsor Guidelines, including the minimum paid-up capital requirement of HK$10 million, as well as the general requirements for RA 6 licences.

### Corporate finance advisory firms holding RA 6 licences before the Effective Date

#### 1.Firms that do not intend to act as sponsors:

* must notify such intention before September 30, 2006;
* need not meet the higher minimum paid-up capital requirement of HK$10 million;
* will be imposed with a licensing condition to prevent them from acting as sponsors or undertaking sponsor work; and
* will be able to carry out other types of corporate finance related activities other than acting as sponsors or compliance advisers or other activities not previously proposed in their RA 6 licence application.

#### 2. Firms that intend to act or continue to act as sponsors and have a previous IPO track record (i.e. they have completed at least one IPO transaction on either the Main or GEM Board in the 5 years immediately preceding the Effective Date):

* will be required to make written submissions to the SFC by the Effective Date stating:
	1. that the firm meets the new eligibility criteria to act as sponsor; and
	2. the names and titles of qualified Principals appointed by the firm; and
* will have to provide evidence to the SFC that it is in a position to meet the minimum paid-up capital requirement.

If the SFC is satisfied that a firm meets the new eligibility requirements and is fit and proper to act as a sponsor, it will issue a notification that informs its decision not to impose a no-sponsor work or other restrictive licensing condition. On receipt of such notification, the firm may continue to rely on its existing RA 6 licence to operate as a sponsor. No new licences will be required. Firms who do not meet the necessary criteria will have licensing conditions imposed upon them preventing them from carrying out sponsor work.

#### 3. Firms that intend to act as sponsor but do not have a previous IPO track record:

Firms holding a RA 6 licence before the Effective Date that have not, on a firm basis, completed any IPOs in the preceding 5 years:

* must make a written submission to the SFC confirming compliance with the eligibility criteria under the Sponsor Guidelines, including the names of the Principals appointed and the minimum paid-up capital requirement, and provide supporting evidence that demonstrates the firm’s compliance. Supporting evidence may include the background of respective Principals showing their experience and expertise in the area of sponsors and/or IPOs and the firm’s organisational structure and internal controls.
On receipt of the SFC’s notification of its decision not to impose a no-sponsor work or other similar licensing condition, firms may rely on their existing RA 6 licences to operate as sponsors.

#### 4. Firms that intend to act as compliance advisers

A firm must be eligible to act as a sponsor in order to act as a compliance adviser. Apart from the transitional arrangements for sponsors mentioned above, there are no separate transition arrangements for compliance advisers.

Where a no-sponsor work licensing condition is imposed, the firm is automatically ineligible to conduct compliance adviser work.

The SFC will consider the fitness and properness of firms as well as their compliance with the new eligibility criteria in determining whether they are eligible to act as sponsors. It is entitled to consider all information available in respect of the firm’s sponsor and corporate finance advisory work in considering whether it is fit and proper. Accordingly, firms should consider carefully whether they (and their Principals) meet the new requirements before continuing their existing sponsor work or accepting new mandates during the time between the Effective Date and the receipt of the SFC’s relevant notification.

## F. Commission Inspections

Sponsors and compliance advisers will be subject to the on-going supervision of the SFC. The SFC will be entitled to inspect the operations of sponsors and compliance advisers both on a routine and ad-hoc basis to ensure their compliance with relevant regulations. Failure to comply may result in the SFC imposing licensing conditions and/or issuing restriction notices curtailing a sponsor’s operations. The SFC may also impose a range of sanctions including reprimands, fines, suspension or revocation of licences for breach of the relevant regulatory requirements.

*This note is a summary only of the requirements of the SFC’s proposed new Guidelines for Sponsors and Compliance Advisers. Specific advice should be sought in relation to any particular situation.*

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